# Dechra
Pharmaceuticals PLC

Annual Report and Accounts 2007

## Services
## Pharmaceuticals

An International Veterinary
Pharmaceutical Business

Services
Pharmaceuticals

# Welcome to Dechra



## The Business

An international veterinary pharmaceutical business.

National Veterinary Services

NationWide Laboratories

Cambridge Specialist Laboratory Services

## The Strategy

- To sustain growth from our core businesses
- To continue to develop our veterinary pharmaceutical portfolio
- To increase our pharmaceutical penetration into international markets

## Contents

# Highlights

## Pharmaceuticals

**Dechra Veterinary Products ("DVP")**
Marketing and development of licensed branded pharmaceuticals to the veterinary profession worldwide.

**Arnolds Veterinary Products ("AVP")**
UK market leading supplier of veterinary instruments, consumables and equipment.

**Dales Pharmaceuticals ("DP")**
Licensed manufacturer of veterinary and human pharmaceuticals for DVP and third party customers.

## Services

**National Veterinary Services ("NVS")**
UK market leader in the supply of pharmaceuticals and added value services to the veterinary profession, including management information systems and consumer and internet services.

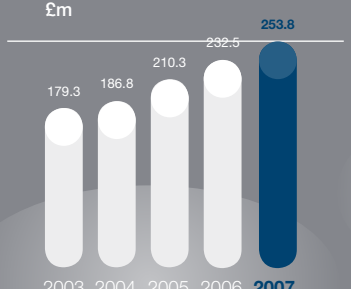
**NationWide Laboratories ("NWL")**
Multi-disciplined independent commercial veterinary laboratory.

**Cambridge Specialist Laboratory Services ("CSLS")**
Primary care and secondary referral specialist veterinary immunoassay laboratory.

The veterinary market for companion animal products is dominated by:

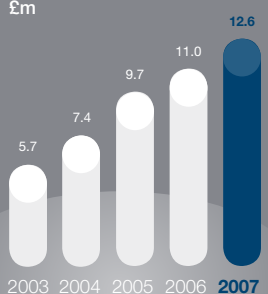
- The US, representing the biggest companion animal market in the world with the number of dogs estimated at over 70 million, cats at 80 million and horses at 7 million.
- Western Europe where, in the UK alone, there are approximately 6.7 million dogs, 7.2 million cats and 1 million horses. The UK veterinary market, including livestock products, has consistently outperformed the Retail Prices Index over the past ten years.
- Japan, which represents a considerable market opportunity with over 13 million dogs.

**Revenue**
£m



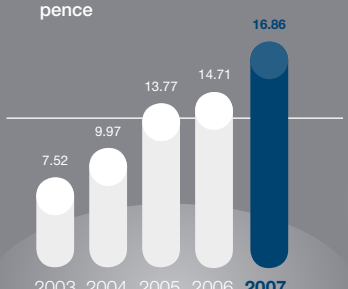

up 9%

**Profit before tax**
£m



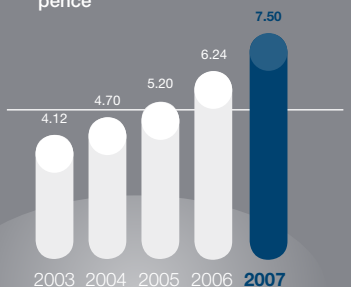

up 14%

**Earnings per share**
pence




up 15%

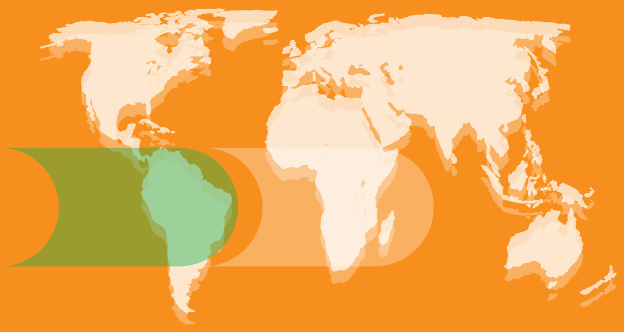
**Dividend per share**
pence




up 20%

Information for the years ended 30 June 2003 and 2004 are prepared in accordance with UK GAAP

# Worldwide Pharmaceuticals



During the last five years we have licensed four specialist products and four generic products, three of which received approval towards the end of the financial year.

Within our current licensed portfolio, *Vetoryl*® Capsules and *Felimazole*® Tablets still provide excellent opportunities for international growth.

## United Kingdom

**44** Current Licensed Products

**5** Products Pending Regulatory Approval

Our lead products in the UK are *Vetoryl*® Capsules, *Felimazole*® Tablets, *Equipalazole*® and the *Vetivex*® range of critical care fluids. Towards the end of the financial year, we received approval for three generic products, *Domidine*®, *Sedator*® and Thyroxyl. Two further generic products are expected to be approved before the end of December 2007.

## Europe

**4** Current Licensed Products

**3** Products Pending Regulatory Approval

*Vetoryl*® Capsules were approved by 19 European territories towards the end of the 2006 financial year.

Revenue in the 2007 financial year, the first full year of marketing, exceeded £1.5 million.

## United States

**7** Current Licensed Products

**3** Products Pending Regulatory Approval

In May 2007, we acquired the rights to the Pharmaderm range of products (see facing page). We are also progressing *Vetoryl*® Capsules, *Felimazole*® Tablets and *Equidone*® Gel through USA Food and Drug Administration ("FDA") approval.

## Rest of the World

**2** Products Pending Regulatory Approval

Our marketing partners are in the process of obtaining regulatory approval for *Vetoryl*® Capsules in Japan, Australia and Canada; and *Felimazole*® Tablets in Canada.

# Acquisitions

## Leeds Veterinary Laboratories Limited

Leeds Veterinary Laboratories ("LVL") is a well-managed operation that has developed a strong reputation for providing a high standard of service. Strategically, LVL increases our market share and skills set within the veterinary laboratories market.

LVL will operate within Dechra's Services division as part of its existing veterinary laboratories operations of NationWide Laboratories and Cambridge Specialist Laboratory Services.

## Pharmaderm Animal Health

The agreement will provide the opportunity for the Group to increase sales and to strengthen its profile and brand awareness within the American veterinary market ahead of the launch of its own developed veterinary products, *Vetoryl*® Capsules, *Felimazole*® Tablets and *Equidone*® Gel which are currently undergoing FDA review.

## *Equidone*® Gel

This product prevents Fescue Toxicity in horses and has an estimated market size in the USA of approximately $2.0 million. Licensing approval is being progressed with the FDA with submission being targeted in 2008.

Services
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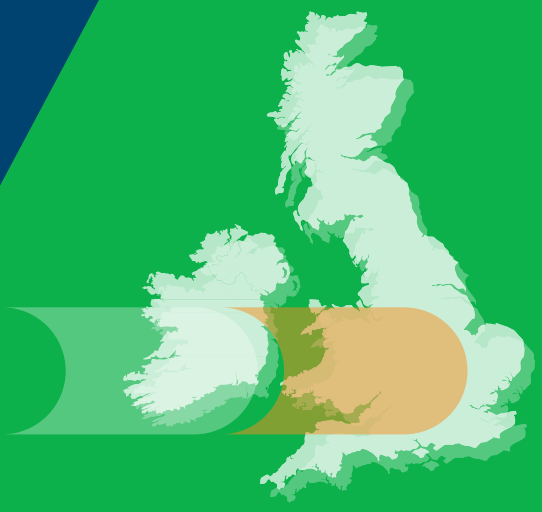
# Services




Our veterinary wholesale business, National Veterinary Services, has an approximate 44% share of the veterinary market in Great Britain, which is measured at over £500 million.

# Chairman's Statement

I am pleased to report that we have continued to achieve good growth in revenue and profitability from our UK businesses; this has been enhanced by significant revenue from our own product portfolio in the EU. Strategic progress has been made with acquisitions that strengthen the Group and provide a revenue stream and platform for growth in the US. The development of our own branded veterinary pharmaceutical portfolio is progressing to schedule.

## Financial Highlights

Group revenue increased 9.2% from £232.5 million to £253.8 million.

Operating profit increased by 12.5% to £13.8 million (2006: £12.3 million) and profit before taxation rose 14.3% to £12.6 million (2006: £11.0 million).

Basic earnings per share was 16.86 pence, up 14.6% from the 14.71 pence achieved in 2006.

Total cash investment in product development was £3.3 million (2006: £1.6 million), of which £1.6 million was charged to the income statement (2006: £1.4 million).

Cash flow continued to be strong with cash flow from operations being 103% of operating profit. As at 30 June 2007, the Group had net funds of £1.0 million, virtually unchanged from the £1.1 million at 30 June 2006.

Interest cover was 11.3 times (2006: 9.7 times).

During the year, the Group acquired the rights to the Pharmaderm range of veterinary products for US$5.0 million (£2.6 million), made an initial payment of US$0.5 million (£0.3 million) for the intellectual property rights for *Equidone* Gel and acquired Leeds Veterinary Laboratories Limited for a cash and equity consideration of £0.8 million.

Further details are contained in the Business Review.

## Dividend

In line with our progressive dividend policy and our confidence in the business, the Directors are recommending an increase in the final dividend to 5.00 pence per share (2006: 4.33 pence per share). This, together with the interim dividend of 2.50 pence per share (2006: 1.91 pence per share), makes a total dividend for the year of 7.50 pence per share (2006: 6.24 pence per share), a 20% increase.

The total dividend is covered 2.2 times by profit after taxation.

The final dividend, which is subject to Shareholder approval at our Annual General Meeting to be held on Wednesday 17 October 2007, will be paid on 23 November 2007 to Shareholders on the Register at 26 October 2007.

## People

On behalf of the Board and all our shareholders, I would like to welcome all the new starters who have joined the Group throughout the year and I would like to thank all employees for their endeavours which have contributed to this strong performance.

## Prospects

Current trading continues to meet management expectations. With the continued solid growth of our UK businesses, the acquisitions made throughout the year and with the international product development programme beginning to deliver revenue, we remain confident in our future.

**Michael Redmond**
Chairman
4 September 2007

*"Cash flow continued to be strong with cash flow from operations being 103% of operating profit."*


Services
Pharmaceuticals

*"With the continued solid growth of our UK businesses, the acquisitions made throughout the year and with the international product development programme beginning to deliver revenue, we remain confident in our future."*


***Above right:*** Our lead product *Vetoryl* Capsules achieved global revenue of over £4.5 million, including over £1.5 million from the EU.

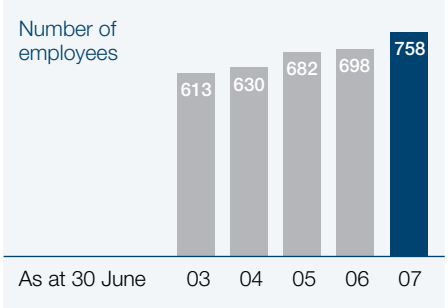
***Main Picture:*** We consider NationWide Laboratories to offer the highest level of service within its sector.

# Directors' Business Review

## The Business and its Markets

Dechra® Pharmaceuticals PLC ("Dechra") comprises six businesses operating under two Divisions, Pharmaceuticals and Services. Both divisions are focused on the veterinary market with a key area of specialisation being on companion animal products.

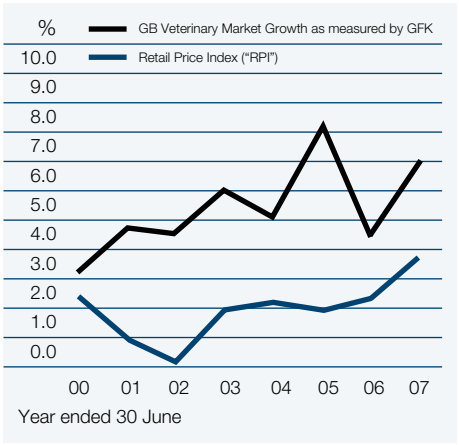
Dechra employs 758 people at 30 June 2007, an increase of 60 employees over the last year, who operate out of 17 locations.




The veterinary market for companion animal products is dominated by North America, Western Europe and Japan. Key drivers within the companion animal market are the increasing medical and surgical capabilities of veterinary surgeons, increased life expectancy of pets and ultimately the consumer's passion for their animals.

The US represents the biggest companion animal market in the world with the number of dogs estimated at over 70 million, cats at 80 million and horses at 7 million. American veterinarians are very advanced in their knowledge of small animal medicine, a key advantage when marketing specialised products such as Dechra's own brands. Sources indicate that Americans spend more per companion animal than any other nation.

Within the UK there are approximately 6.7 million dogs, 7.2 million cats and 1 million horses. The UK companion animal market is also considered to be highly advanced in terms of spend per animal and veterinarian competence. There has been an increase in the number of generic drugs entering the market over the last few years; however, unlike the human market, this does not result in a massive devaluation. The UK veterinary market, including livestock products, has consistently outperformed the Retail Prices Index ("RPI") over the past ten years.




The remainder of the EU, in terms of the number of animals, is potentially commensurate with the US. Despite this, however, the market is currently considerably less as dogs and, particularly cats, have little value in many communities. Historically, the majority of pets have not had regular contact with a veterinary surgeon and, with the exception of some major conurbations, small animal veterinary science is not that advanced. However, the companion animal market is developing quickly in Northern Europe; the EU, therefore, represents an important long-term growth opportunity for Dechra. Japan represents a considerable market opportunity with over 13 million dogs, with other territories with relevant sized companion animal markets being Canada and Australia.

## Product Development

### Strategy

The Group focuses on solid organic growth within its Pharmaceutical and Service Divisions; however, the key strategic focus to deliver medium to long-term growth is through the development and acquisition of our own branded veterinary pharmaceutical portfolio of both novel and generic products and the licensing of these key products into international markets. Our product development is focused entirely on prescription only veterinary medicines for dogs, cats and horses, with our main area of specialisation being within endocrinology. Most of our projects utilise existing pharmaceutical entities that are typically used within the human market and therefore the majority of product creation is development and not research based. There are a number of benefits to our strategy relative to traditional human and veterinary pharmaceutical R&D, which include:

- An identified, existing pharmaceutical product can often be brought to full licence for the veterinary market within five years;
- After minimal expenditure on early explorative project evaluation, an identified human pharmaceutical has a high probability of achieving a veterinary licence;
- Development projects have a high probability of success with relatively low cost; research

*Left: Vetoryl* Capsules still provide excellent opportunities for international growth.

Services
Pharmaceuticals

*"The key strategic focus to deliver medium to long-term growth is through the development and acquisition of our own branded veterinary pharmaceutical portfolio of both novel and generic products and the licensing of these key products into international markets."*


***Above left:*** *Felimazole* Tablets achieved global revenue of £3.4 million in the 2007 financial year with £2.9 million coming from the UK.

***Main Picture:*** NVS stocks a range of over 12,000 products and processes over 34,000 invoiced lines per working day.

based projects are usually expensive with low probability of product success;

- Products entering other species, i.e. food producing animals, take considerably longer to license as expensive food safety and toxicological studies are required;
- Clinical trials for veterinary medicines typically require a few hundred cases, while human trials demand several thousand.

### Legislation

There are three pieces of legislation, which the Directors believe have been implemented to encourage development of specialised veterinary products into relatively small markets. Dechra considers this legislation to be favourable towards its strategy:

- The "Cascade Legislation": The basic principle of this EU legislation is that the veterinary surgeon must prescribe a veterinary licensed product above any other alternative. Therefore, any products licensed specifically for animals must be used instead of a human ethical or generic product, irrespective of price;
- EU law gives a novel product ten years' protection from generic competitors, irrespective of its patent status;
- The US Centre of Veterinary Medicine ("CVM") provides five years' protection from generic competitors for the first approval of a new pharmaceutical, irrespective of its patent status. Subsequent approvals receive three years' protection.

### Licensing Authorities

Dechra considers that one of the most unpredictable aspects of product licensing is the response time from the Regulatory Authorities globally. EU regulators provide definitive response times based on a number of working days, but this can vary depending on the type of application. However, these time lines can be stopped intermittently if the assessor considers that parts of the application need further supporting information. The US FDA has a similar target response time for novel products; however, they are not currently meeting their internal targets.

There is an extensive backlog of applications for generic products for the US market, where the FDA have no obligations on response time. We currently have no generic products under development for the US market. Other regulators, such as Canada and Japan, provide little guidance on timing and as a result the process can take several years. Dechra has endeavoured to mitigate the potential for delays by providing increasing investment in product development year on year. Further investment has been made throughout the financial year in strengthening our regulatory department both in the UK and the US, with additional investment in people and also equipment in our development laboratory.

### Key Strengths

The Directors believe that the Group has exceptional skills and expertise that are relevant to delivering its strategy:

- The recognition of opportunities for specialised and niche pharmaceutical products for the veterinary market achieved from knowledge gained from the Group's strong market position;
- In-house formulation of products into preparations suitable for the target species;
- International experience and proven track record of regulatory and licence delivery;
- Successful design and management of international clinical field trials;
- Industry leading veterinary and commercial personnel throughout the Group.

### Achievements

During the last five years we have licensed four specialist products and four generic products, three of which received approval towards the end of the financial year. Within our current licensed portfolio, *Vetoryl* Capsules and *Felimazole* Tablets still provide excellent opportunities for international growth.

*Vetoryl* Capsules is a novel and patented product for the treatment of Cushing's Disease (excess cortisol or hyperadrenocorticism) in dogs. It is the only licensed product within the EU and is the only recognised safe and efficacious veterinary product for the treatment of Cushing's Disease around the world. Launched in the UK on a provisional marketing authorisation in September 2001, *Vetoryl* Capsules has since achieved full approval and has consistently increased market penetration, with substantial revenue now in excess of £2.0 million per year. It also achieved mutual recognition for approval within the EU in 2006 and has now been launched within all the key European territories with good initial sales exceeding £1.5 million. In the US it is also sold under an FDA waiver scheme. Global revenue for *Vetoryl* Capsules in the 2007 financial year was £4.5 million.

*Felimazole* Tablets is the first veterinary licensed product for the treatment of feline hyperthyroidism. It competes in the world's markets against human equivalents; however, the Cascade Legislation (see Legislation) has supported its growth. *Felimazole* Tablets received marketing approval in 2002 and has achieved UK revenues in excess of £2.9 million in the financial year. *Felimazole* Tablets was approved in the EU in 2005 and has achieved £0.4 million sales in the year. This relatively low level of sales can be attributed to the failure of veterinarians to comply with the Cascade Legislation (see Legislation) and the status of the cat throughout most of the EU (see The Business and its Markets).

***"Through the Group's strong market position, exceptional skills and expertise, we have the ability to recognise opportunities for specialised and niche pharmaceutical products for the veterinary market."***

Both *Vetoryl* Capsules and *Felimazole* Tablets have been granted an expedited review status by the FDA in the US. The principal advantage to an expedited review is that there is a target 90-day response from the time of the submission of information.

### Development Update

There have been a number of achievements within our development programme throughout this financial year:

- The safety and CMC sections for *Vetoryl* Capsules were submitted to the FDA prior to the financial year end. The submission of the efficacy section is imminent. An initial response to the CMC section has been received with only three areas requiring further clarification, none of which should result in delayed approval. We remain confident in the safety and efficacy of the product and await a response from the FDA;
- All cats have now been enrolled on the clinical trial for *Felimazole* Tablets. We anticipate that the efficacy submission will be made prior to the end of this calendar year;
- Clinical trials have commenced in Japan and are progressing to our expectations. These trials are the responsibility of our partner Kyoritsu Seiyaku ("KS"), who are the leading animal pharmaceutical supplier with over 60 representatives marketing directly to veterinary practices. KS anticipate that it will be at least a further two years to gain approval within this significant territory;
- As reported last year, the dossier for *Vetoryl* Capsules has been submitted to the Canadian and Australian authorities and the dossier for *Felimazole* Tablets has been submitted in Canada. We understand that the review process has now commenced within these territories;
- A 10mg small dog *Vetoryl* Capsule has been approved within the EU; marketing is expected to commence within the next six months. The US approval for the 10mg strength will be concurrent with the full application;
- *Intra-Epicaine*® and *Somulose*®, two of the minor, although unique products in our portfolio, have been approved for sale in Ireland;
- Two *Vetivex* range extensions have received UK approval;
- Three generic products, *Domidine*, *Sedator* and Thyroxyl have received approval for the UK. *Domidine* and Thyroxyl were launched towards the end of the financial year;
- Two other generic products are at an advanced stage of the approval process and are expected to be licensed within the first half of the current financial year;
- Progress is also being made with three further generic products which will be targeted at the EU market.

We currently have a number of other products under development and are exploring several other opportunities to add to the portfolio. Due to commercial sensitivity we believe it to be appropriate to treat the nature of these projects as confidential.

## Acquisitions

### Intellectual Property Acquisition

In December 2006 we announced that we had acquired the intellectual property for *Equidone* Gel, an equine product, which is at an advanced stage of development for the US market.

The use of the active ingredient, Domperidone, has been co-developed by Equi-Tox and Clemson University, based in South Carolina, US for the prevention of Fescue Toxicity, a disease which is caused by eating a fungus which infects tall fescue grass. The most serious clinical signs are observed in the late stages of pregnancy and the toxicity can result in foal death.

*Equidone* is already patented and under limited distribution in the US under a special licence. The market for equine Fescue Toxicity is estimated to be approximately US$2.0 million per annum. Other patents for *Equidone* uses have also been approved; explorations into these indications, which have substantially larger markets, have commenced.

### Laboratory Acquisition

In April 2007 we announced the acquisition of Leeds Veterinary Laboratories Limited ("LVL"). LVL is a well established veterinary laboratory, founded in 1986. The business employs 18 staff and three consultants and offers a comprehensive range of veterinary diagnostic tests for companion, exotic, equine and farm animals from its 6,000 sq. ft. facility in Yeadon, Leeds, Yorkshire. The effective cash and equity consideration for LVL was £750,000.

### US Veterinary Product Portfolio

In May 2007 we secured a long-term trademark license and supply agreement with Pharmaderm Animal Health ("Pharmaderm"), part of the US commercial division of ALTANA Inc.

The agreement provides the Group with exclusive marketing and distribution rights for a range of veterinary licensed ophthalmic, otic and dermatological products and the opportunity to develop new licences for both North America and Europe.

Under the agreement, Dechra paid US$5.0 million in cash for the licences. The products, which are currently sold to veterinary practices in the US, achieved sales of US$7.7 million in



*Left:* *Equipalazone*, our market leading non-steroidal anti-inflammatory drug, grew by 12% in the UK.

*Right:* Thyroxyl was launched towards the end of the financial year.

the year ended 31 December 2006.

## Pharmaceutical Division

Our Pharmaceutical Division comprises Dechra Veterinary Products ("DVP EU"), Dechra Veterinary Products USA ("DVP USA"), Arnolds Veterinary Products ("Arnolds®") and Dales Pharmaceuticals ("Dales").

### Dechra Veterinary Products EU

DVP EU, located in Shrewsbury, England, employs 67 people. This business markets and sells our own branded, licensed veterinary pharmaceuticals in the UK, and manages the relationships with our EU marketing partners. We have over 40 products; however, there are 13 key brands which represent over 90% of DVP EU's sales. We have a number of UK marketing agreements; with Virbac Inc. to market Thyroxyl within the UK and Ireland, with Eurovet to market *Domidine* and *Sedator* in the UK and Ireland, with Biopure to market *Oxyglobin*® in the EU and with Peptech to market *Ovuplant*® in the EU. Thyroxyl is a generic product used for the treatment of Hyperthyroidism in dogs. *Domidine* and *Sedator* are generic analgesics used in the treatment of horses and dogs respectively. *Ovuplant* is a seasonal equine fertility product, launched in the UK in Spring 2005; development is progressing to licence the product within the rest of the EU. *Felimazole* Tablets and *Vetoryl* Capsules, together with *Equipalazone* Powder, Paste and Injection, the market leading equine Non-Steroidal Anti-Inflammatory Drug ("NSAID"), are marketed within the EU by various partners, the key territories being serviced by Janssen, Intervet and Orion.

DVP EU, as outlined in the Financial Review, grew strongly throughout the year. This can be principally attributed to an increase in sales of *Vetoryl* Capsules and *Felimazole* Tablets within the UK and EU and also the successful launch, towards the end of the period, of the generic products outlined above. *Vetoryl* Capsules sales have been enhanced by the production of an interactive DVD which is utilised as a technical sales aid.

The Arnolds business has been consolidated within DVP EU; the *Vetivex* range of products are now marketed by the pharmaceuticals team. *Vetivex* continues to grow with an increase in market share of over 6%. Two new presentations, 100ml Sodium Chloride and 250ml Hartmann's Solution, which were licensed in the year, have further differentiated our range from our main competitor. UK sales of *Equipalazone*, our market leading NSAID, grew by 12% despite competing with a new entrant within the sector; however, EU revenues fell slightly due to phasing of large EU export orders.

Within the year, three veterinary surgeons were appointed. Greg Williams and Alison Roberts strengthen our technical support and Dr Michael Hemprich has taken on the role of European Account Manager to further develop our relationship with our EU marketing partners and to explore other European opportunities.


**DVP EU**

*Left picture, from left:* Giles Coley, Managing Director; Mark Sallin, Finance Director; Chris Kingdon, Pharmaceutical Sales Director; Gwenda Bason, Pharmaceutical Marketing Director.

**DVP USA**

*Right picture, from left:* Dr Erin Evans, Manager, Technical Services; Mike Eldred, President; Chris Huettner, Customer Service/Office Manager; Chip Whitlow, Vice-President Sales and Marketing.

## Pharmaceuticals Division

Services
Pharmaceuticals

*"We currently have a number of other products under development and are exploring several other opportunities to add to the portfolio."*


***Above right:*** *Domidine*, a general analgesic used in the treatment of horses, was launched towards the end of the financial year.

***Main Picture:*** Dales Pharmaceuticals is a Medicines and Healthcare Regulatory Agency ("MHRA") fully approved pharmaceutical manufacturer with multi-competence in both scale and dose form.

# Directors' Business Review continued

## Dechra Veterinary Products USA

This business, employing five people, was established in 2005 and is located in the Kansas City animal health corridor, US. It has been significantly strengthened by the Pharmaderm licensing deal (see Acquisitions), which provides a range of seven licensed veterinary brands. This agreement is a major achievement for the Group; it provides the opportunity to increase sales and to strengthen our profile and brand awareness within the American market ahead of the launch of our own developed products.

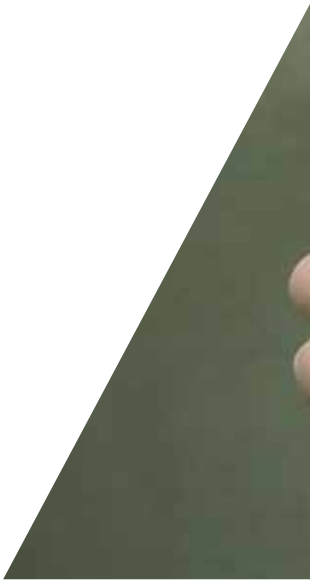
Furthermore, it has enabled us to extend the management team with the appointment of Manager, Technical Services, Dr Erin Evans, Chris Huettner, Customer Service/ Office Manager and an experienced sales professional, Tammy Rice, who has joined us from Pharmaderm. The management team are now looking to make further appointments within the sales department.

The US market is very significant to Dechra's strategy, being approximately ten times the size of the UK market. We anticipate immediate growth from the Pharmaderm range of products and significantly increased pharmaceutical revenues once *Vetoryl* Capsules, *Felimazole* Tablets and *Equidone* Gel receive approval.

## Dales

Dales, located in Skipton, Yorkshire, employing 155 people, is a fully Medicines and Healthcare Regulatory Agency ("MHRA") approved pharmaceutical manufacturer with multi-competence in both scale and dose form. Dales manufactures the vast majority of our own branded licensed pharmaceutical products, which are marketed through DVP EU, but also derives approximately 50% of revenues from third party toll manufacture, predominantly for human pharmaceutical companies. This is Dechra's only significant source of revenue not derived from the veterinary market. As major volume pharmaceutical manufacturing becomes increasingly dominated by India and China, our capabilities on multiple scale production and specialisation (i.e. controlled drugs) allow us to maintain and write new contracts.

Throughout the year we have again strengthened the Quality Department with a target to seek FDA approval for one of our products within two years. Continued focus on efficiency and quality systems has resulted in a strong performance for the year. This has been enhanced by full-scale production of a £1.0 million per annum contract, which was announced at the end of the last financial year.



**Dales**

***Clockwise from top left:*** Mike Annice, Managing Director; Steve Dewar, Operations Director; Gareth Davies, Sales & Marketing Director; Kirsty Ireland, Finance Director.

## Pharmaceuticals Division

Services
Pharmaceuticals

*"The US market is very significant to Dechra's strategy, being approximately ten times the size of the UK market."*


***Above right:*** *Sedator* achieved approval for the UK market towards the end of the 2007 financial year and was launched in July 2007.

## Services Division

Our Services Division comprises National Veterinary Services ("NVS®"), NationWide Laboratories ("NWL") and Cambridge Specialist Laboratory Services ("CSLS").

### NVS

NVS, located in Stoke-on-Trent, England, employing 460 people, is the UK market leader, as measured in terms of market share, in the supply and distribution of veterinary products to veterinary practices and other approved outlets. NVS competes with two major full line competitors on the UK mainland, Centaur Services and Dunlops.

NVS stocks a range of over 12,000 products including pharmaceuticals, pet products, consumables and accessories. NVS has also developed a range of IT solutions for veterinary practices which are branded *Vetcom*®. *Vetcom*'s principal objective is to collect orders electronically. Approximately 80% of NVS' orders arrive automatically with no human input required. This is considered to be a major advantage to our customers and also contributes to our low operating costs. With over 34,000 invoiced lines per working day, significantly increased numbers of people would be required to handle this business manually. NVS distributes to 1,700 customers daily utilising its own fleet of vans and HGVs. The centralised stock in Stoke-on-Trent is picked and packed throughout the afternoon and evening and then distributed overnight to trunking depots by HGVs on large trailers. Van drivers are then employed locally at these depots who distribute the goods to the customers. NVS operates on a Sunday until Thursday shift which allows customers to place orders up until 7.00 p.m. Monday to Thursday and any time over the weekend up to 10.00 a.m. Sunday for a next working day delivery.

NVS services both companion animal and livestock practices and agricultural merchants, with sales being approximately 60% in favour of companion animal related products. As with other divisions within Dechra, NVS benefits from the solid growth in the veterinary market (see The Business and its Markets).


NVS Network

**NVS**

***Clockwise from top left:*** Martin Riley, Managing Director; Tony Scott, Operations Director; Caitrina Harrison, Sales & Marketing Director; Colin Higham, Buying Director; Dan Shipman, Finance Director.

## Services Division

Services
Pharmaceuticals

*"Another very strong performance from NVS, demonstrated by a retention of our market share at 44% and a revenue growth rate ahead of the market."*

***Above right:*** The £700,000 investment made last year in automation and capacity within the central NVS warehouse is now fully commissioned and has improved productivity and overall operational efficiency.

***Main picture:*** NVS distributes to 1,700 customers daily utilising its own fleet of vans and HGVs.

# Directors' Business Review continued

At the beginning of the year the management team made a strategic decision to arrest the year-on-year increase in discount allowed to customers and to increase the focus on the high levels of customer service, new services and strong alliances with our customers. This strategy has proved to be successful with another very strong performance from NVS, demonstrated by a retention of our market share at 44% and a revenue growth rate ahead of the market. Two IT innovations have performed well throughout the year; Vpod, launched in March 2006, now has in excess of 200 users and VetKiosk, an innovative marketing and merchandising terminal designed for practice waiting-rooms, is also being well received by the profession. NVS are marketing VetKiosk in partnership with the innovators Onstream. As previously reported, the £700,000 investment made last year in automation and capacity within the central warehouse is now fully commissioned and has improved productivity and overall operational efficiency.

## Laboratories

NWL operates out of three locations, Poulton-le-Fylde (Lancashire), Leeds (Yorkshire) and Swanscombe (Kent), and employs 63 people. As first referral veterinary laboratories, they provide histology, pathology, haematology, chemistry and microbiology services to veterinary practices. Whilst a certain amount of simple chemistry is performed at veterinary practices, nearly all veterinary practices will outsource more advanced analytical tests, often requiring expert interpretation of results. We consider NWL to offer the highest level of service within this sector. We were the first veterinary laboratory to gain UKAS (United Kingdom Accreditation Service) approval. NWL also offers other services such as *Allervet*®, a pet and equine allergy testing programme, and Petscreen, a chemotherapy sensitivity test for small animal tumours.

CSLS, located in Sawston (Cambridgeshire), England employs seven people. It operates as a first and second referral laboratory, with a key area of expertise being endocrinology. The second referral work, i.e. providing services for NWL and some of NWL's competitors, is mainly derived from a key area of specialisation in radio-immuno assays. The business also provides precise assays which support the dosage regimes and patient monitoring of our key products, *Vetoryl* Capsules and *Felimazole* Tablets.

The acquisition of LVL (see Acquisitions) has strengthened our service offering and increased our market share. Additionally, LVL has increased our skill set within the veterinary laboratory market, particularly in the agricultural animal sector. We are progressing to plan in the integration of LVL, which has been re-branded to NWL. The Swanscombe satellite laboratory in the south of England, which opened at the beginning of the year, has continued to attract new accounts.

**Laboratories**

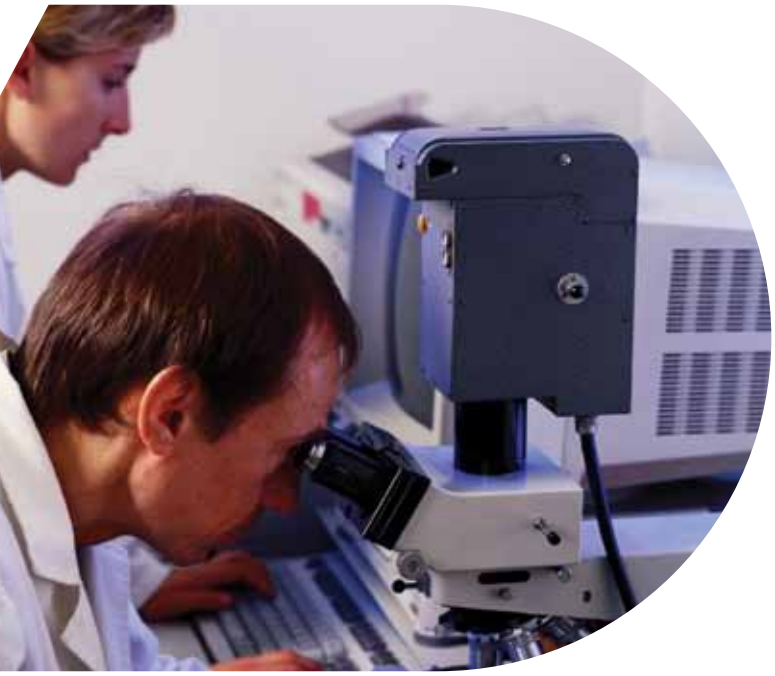
*From left:* Tariq Shah, Sales and Marketing Manager; Dr Peter Graham, Managing Director; Jamie Whitwam, Food Microbiology and Business Development Manager.

## Services Division

Services
Pharmaceuticals

*"We were the first veterinary laboratory to gain UKAS (United Kingdom Accreditation Service) approval."*

***Main Picture:*** During the year, our laboratories business expanded its geographical coverage by opening a satellite laboratory in Swanscombe, Kent and acquiring LVL.



## Key Performance Indicators

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Revenue — pharmaceuticals | **26,648** | 23,252 |
| — services | **234,207** | 215,556 |
| — inter-division | **(7,052)** | (6,337) |
| | **253,803** | 232,471 |
| Operating profit before product and USA development cost | **15,692** | 13,950 |
| Product and USA development cost | **(1,843)** | (1,638) |
| Operating profit | **13,849** | 12,312 |
| Operating margin — Before product and USA development cost | **6.2%** | 6.0% |
| — After product and USA development cost | **5.5%** | 5.3% |
| Cash conversion rate | **103%** | 114% |
| Gearing (i) | **(3.5%)** | (4.7%) |
| Return on capital employed (pre-tax) | **37.5%** | 34.9% |
| Revenue per employee | **340** | 336 |
| Inventory days (ii) | **42** | 37 |
| Receivables days (iii) | **40** | 41 |

### Financial Ratios

| | | |
|---|---|---|
| Interest cover | **11.3 times** | 9.7 times |
| Effective tax rate | **29.9%** | 31.6% |
| Dividend cover | **2.2 times** | 2.3 times |

(i) Gearing is calculated by dividing net cash by the sum of Equity Shareholders' funds and net cash.

(ii) Inventory days are calculated by determining the number of days' purchases, counting back, included in the year end inventory figure.

(iii) Receivables days are calculated by determining the number of days' revenue (adjusted for value added tax),

## Review Of Operating Performance

### Group Performance

The 2007 financial year saw encouraging progress from both of our Divisions with each achieving healthy revenue growth and improvements in operating margin.

Overall, Group revenue grew by 9.2% for the year whilst operating profit was up by 12.5%.

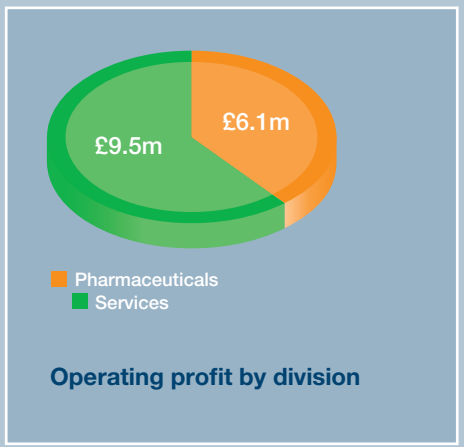
The Group achieved a pre-tax profit of £12.6 million, an improvement of 14.3% compared to last year.

The results are reviewed in more detail on a Divisional basis below:

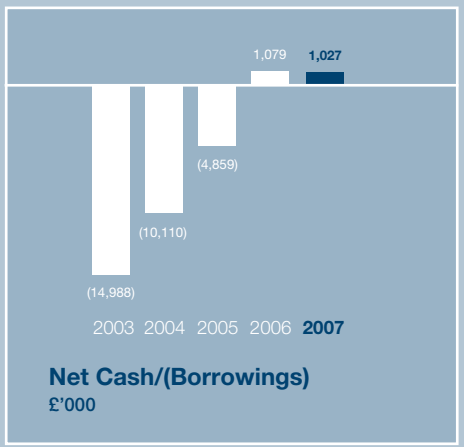
### Pharmaceuticals Division

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Revenue | | |
| Own branded pharmaceuticals | **16,599** | 13,565 |
| Instruments, consumables, and equipment | **3,817** | 3,878 |
| Third party contract manufacturing | **6,232** | 5,809 |
| Total revenue | **26,648** | 23,252 |
| Operating profit | **6,081** | 4,868 |
| Operating margin | **22.8%** | 20.9% |

## Performance Charts




**Operating profit by division**




**Net Cash/(Borrowings)**
£'000

The *Vetivex* range of products is now shown within own branded pharmaceuticals rather than instruments, consumables and equipment and the comparative figures have been adjusted accordingly.

Revenue from own branded pharmaceuticals grew strongly at 22.4% compared to last year. The principal drivers of this growth continued to be our lead products *Vetoryl* Capsules and *Felimazole* Tablets. *Vetoryl* Capsules achieved global revenue of £4.5 million, a 56.8% increase over the £2.9 million achieved last year. Within this figure, European revenue was £1.5 million (2006: £0.2 million), an encouraging performance in our first full year of marketing in this territory.

Global revenue from *Felimazole* Tablets increased by 39.0% to £3.4 million (2006: £2.4 million) with most of this increase coming from the UK.

With regard to our other key products, global revenue from *Equipalazone*, our long established equine product, fell slightly by 1.3% to £2.7 million. However, the *Vetivex* range of critical care fluids showed growth of 18.8% to £1.5 million.

On 14 May 2007, the Group acquired the marketing and distribution rights to the Pharmaderm range of veterinary licensed products (see Acquisitions). At the time of acquisition, annualised revenue was US$7.7 million. As this acquisition happened towards the end of the financial year, there is only a relatively small contribution within the figures being reported on. The financial year ending 30 June 2008 will see the full benefit.

Revenue from instruments, consumables and equipment fell by 1.6% due to continued competitive pressure and from "grey market" imports.

Revenue from third party contract manufacturing increased by 7.3% to £6.2 million with the benefit of the new £1.0 million contract announced last year starting to be realised in the second half of the financial year.

Product development expenditure charged to the income statement increased by 19.4% to £1.6 million. A further £1.7 million of development expenditure was capitalised. The total cash investment in product development during the year was therefore £3.3 million, more than double the £1.6 million invested last year.

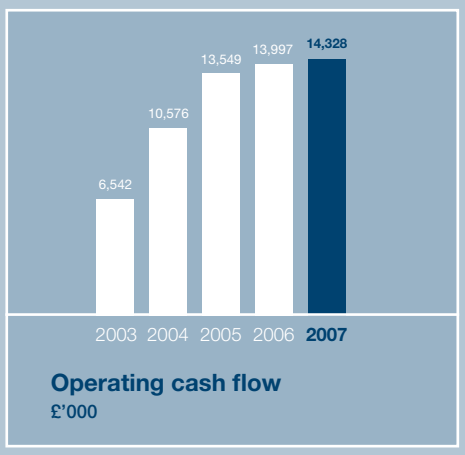
Operating profit for the Pharmaceuticals Division increased by 24.9% to £6.1 million. This strong performance reflects a higher proportion of revenue from own branded pharmaceuticals and further efficiency improvements at our Dales manufacturing facility.

**Services Division**

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Revenue | | |
| Veterinary wholesaling | **229,840** | 211,759 |
| Laboratories | **4,367** | 3,797 |
| | **234,207** | 215,556 |
| Operating profit | **9,519** | 8,681 |
| Operating margin | **4.1%** | 4.0% |

Our veterinary wholesaling business, NVS, grew revenue by 8.5% ahead of last year. This compared to market growth as measured by GfK of 7.8%. Growth in operating costs was contained at a lower level than the growth in revenue, allowing NVS to improve operating profit by 10.0%.

There was much activity within our laboratories business during the year, with the acquisition of Leeds Veterinary Laboratories (see Acquisitions) and the opening of a new laboratory in Swanscombe, Kent. This expanded geographical coverage was reflected in revenue growth of 15.0%. Although growth in operating profit was restricted by the set-up costs for the Swanscombe laboratory, we did achieve an improvement compared to last year.




**Operating cash flow**
£'000

# Directors' Business Review continued

## Unallocated Central Costs

Central costs for the year increased by £0.5 million to £1.8 million. This increase was due to salaries, an increase in the charge relating to share-based payments and a one-off tax advisory fee.

## Return on Capital Employed ("ROCE")

A key focus of the Group has been to make efficient use of the capital that we employ. We measure ROCE by dividing operating profit by average operating assets utilised during the year. Operating assets exclude cash and cash equivalents, borrowings, tax and deferred tax balances.

A further increase in ROCE was achieved this year with the figure rising from 34.9% to 37.5%, reflecting the continued strong trading performance of the Group.

## Net Finance Expense

The net finance expense showed a small reduction from £1.27 million to £1.23 million. A reduction in average debt levels during the year was offset by increasing interest rates.

The net finance expense was covered 11.3 times by operating profit (2006: 9.7 times).

## Taxation

The effective tax rate this year was 29.9% compared to 31.6% last year. The tax charge has benefited from research and development tax credits and a reduction in the rate at which deferred tax is provided from 30% to 28%, the changes to tax rates contained in the 2007 Budget having been substantively enacted at 30 June 2007.

During the year, additional tax credits totalling £455,000 relating to share-based payments were recognised directly in equity.

## Earnings per Share and Dividend

Earnings per share increased by 14.6% from 14.71p to 16.86p.

The Board is proposing a final dividend of 5.00p per share which, when added to the interim dividend of 2.50p per share already paid, gives a total dividend for the year of 7.50p, a 20.2% increase over the 2006 figure of 6.24p. Even with this substantial increase, the total dividend is covered 2.2 times by profit after taxation (2006: 2.3 times). This is ahead of our medium term target cover of 2.0 times. There is therefore scope, subject to investment requirements, to continue to increase the dividend ahead of earnings.

## Cash Flow

The Group achieved a cash conversion rate (defined as cash generated from operations as a percentage of operating profit) of 103.5% (2006: 114%). This was ahead of the target of 100%.

Major cash outflows were on intangible assets (including development costs) of £4.5 million, acquisition of subsidiaries of £0.7 million, other capital expenditure of £0.8 million, income taxes of £2.9 million, dividends of £3.6 million and debt repayments of £3.5 million.

**Financial Position at the end of the Year**

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Non-current assets | | |
| Intangible assets | **13,089** | 7,527 |
| Property, plant and equipment | **5,739** | 5,595 |
| Deferred tax assets | **—** | 445 |
| | **18,828** | 13,567 |
| Working capital | **13,264** | 11,774 |
| Current tax liability | **(2,464)** | (2,505) |
| Deferred tax liabilities | **(147)** | — |
| Net cash | **1,027** | 1,079 |
| Equity shareholders' funds | **30,508** | 23,915 |

The financial position at the end of the year was strong, with equity shareholders' funds standing at £30.5 million.

The major additions to intangible assets were the Pharmaderm products (£2.6 million), development costs (£1.7 million) and the acquisition of Leeds Veterinary Laboratories Limited (£0.8 million including goodwill). Additions to property, plant and equipment were £1.1 million.

Working capital increased by 12.7% over last year, slightly higher than the growth in revenue. The number of days revenue included in inventory increased from 37 to 42. This was due to an initial stocking-up order following our acquisition of the Pharmaderm products and the build up of the inventory of a key NVS supplier in anticipation of a price rise. Receivable days fell from 41 days to 40 days.

Net cash at the balance sheet date was virtually unchanged compared to last year's figure. As normal, due to the working capital cycle of the Group, there will be a return to a net borrowings situation at the next reporting date of 31 December 2007.

## Group Funding

The Group is funded by £28.6 million of called up share capital, a £14.2 million term loan from Bank of Scotland repayable in instalments ending in 2010 and various finance lease and hire purchase contracts.

The Group also has available a £5 million revolving credit facility committed until 2010 and a £4 million overdraft facility renewable annually to fund the Group's working capital requirements. These are only partially utilised at peak working capital points during the year.

## Treasury Policy

The Group's treasury policy is set by the Board and monitored by the Group Finance Director.

The Company does not speculate on short-term interest rate or exchange rate movements.

The Group seeks to hedge for interest rate risk between 20% and 80% of its outstanding borrowings. Currently, £4.733 million of outstanding loans are subject to a floor and ceiling arrangement whereby the effect of fluctuations in LIBOR rate are limited to between 4.53% and 5.50%.

All finance leases and hire purchase contracts are at fixed rates.

Foreign exchange exposure is hedged naturally as far as possible by matching receipts and payments in the relevant foreign currency. To this end, the Group maintains Euro and US Dollar accounts. Unmatched foreign currency exposure is hedged by the Group Finance Director in accordance with Group policy.

No borrowings are denominated in foreign currencies.

## Liquidity Management

The Group's cash position is monitored on a daily basis by the Group Finance Director. As noted above, the Group has available overdraft and revolving credit facilities from Bank of Scotland for its day-to-day working capital requirements.

Further information on Financial Instruments is shown in note 20 to the Consolidated Financial Statements.

## Risks and Uncertainties

Like every business, the Group faces risks and uncertainties in both its day-to-day operations and the achievement of its long term strategic objectives. The Group has well established procedures for identifying and controlling risk. Significant risks and procedures to control them are reviewed at Divisional Board Meetings on a monthly basis and by the Main Board on a quarterly basis.

The main potential risk areas identified by the Directors are as follows:

### Regulatory

Like the human pharmaceutical industry, the veterinary industry is tightly regulated. Our major operational sites are required to be licensed either by the MHRA or the Home Office, and our products by the Veterinary Medicines Directorate ("VMD"). Inspections by these bodies are carried out regularly.

All of our new pharmaceutical products are required to be approved for sale by the relevant Regulatory Authority in each territory.

The main regulatory risks faced by the Group are:

- Failing to operate our businesses in accordance with their licences resulting in disruption to operations;
- Potential reclassification of major pharmaceutical products from prescription only to a lower category causing loss of revenue;
- Failure to satisfy the regulatory authorities on new product submissions causing product launches to be delayed or aborted;
- Changes to the law or adverse reactions causing threat to existing products.

### Corporate Veterinary Practices

The growth of corporate veterinary practices has been a feature of the veterinary market over the last few years. Most corporates currently trade with NVS. The rise of corporate practices provides opportunities and risks to the Group.

The opportunities arise when a corporate group acquires veterinary practices not currently trading with NVS. The risks arise from the potential increased buying power of corporates causing pressure on gross margin. Additionally, a payment default could cause a material impairment charge.

### General Market Conditions

The overall veterinary market has shown robust growth for many years. However, there have in the past been periods when the market has suffered a significant slow down. This can be caused by external "shocks" such as BSE or general economic conditions. Our past experience has been that these slowdowns have been short term in nature. However, given the relatively high operational gearing of NVS, in particular, any future market slowdown could have a material effect on short term profitability.

### Summary of Risks

The Group has ongoing and embedded procedures in place to control and, as far as possible, mitigate against the above risk factors. It must be emphasised, however, that these procedures can only control rather than eliminate risk.

**Ian Page**
Chief Executive

**Simon Evans**
Group Finance Director

# Directors and Senior Management

*From left:* Simon Evans, Ian Page, Ed Torr

*From left:* Michael Redmond, Malcolm Diamond, Neil Warner

## Executive Directors

### Ian Page•
**Chief Executive**
Aged 46, Ian joined the Group's principal trading subsidiary NVS at its formation in 1989. He was also part of the MBO in 1997. In 1998, he was appointed Managing Director at NVS. He joined the Board in 1997 and became Group Chief Executive in November 2001. Ian has played a key role in the development of the Group's growth strategy. Prior to joining the Company, he gained extensive knowledge and experience through various positions he held within the pharmaceutical and veterinary arena.

### Simon Evans BCom, ACA
**Group Finance Director**
Aged 43, Simon qualified as a Chartered Accountant in 1988 and spent seven years at KPMG. He joined NVS in 1992 and was appointed Group Finance Director in 1997 following the MBO. He played a major role in the management buy-out of the Group from Lloyds Chemists in 1997 and its subsequent listing on the London Stock Exchange in 2000.

### Ed Torr
**Development Director**
Aged 47, Ed joined NVS as Sales Director in 1997 and he was appointed Managing Director of Arnolds and Dales in 1998. He relinquished this role in 2003 to focus on his Main Board responsibilities, specifically the strategic development of the Group's licensed veterinary pharmaceutical portfolio in key international territories. Prior to joining the Group, he worked within the animal healthcare sector for a number of companies including ICI, Wellcome and Alfa Laval Agri. He is currently the Vice-Chairman of NOAH (National Office of Animal Health).

## Non-Executive Directors

### Michael Redmond *†•
**Non-Executive Chairman**
Aged 63, Michael joined the Group as a Non-Executive Director in April 2001, and was appointed Chairman in July 2002. He has extensive pharmaceutical industry experience having begun his career with Glaxo and through senior positions with Schering Plough Corporation. In 1991, he joined Fisons plc and in 1993 was appointed to the Board as Managing Director of the Group's Pharmaceuticals Division. Michael left Fisons in 1995 following its takeover by RPR. He also recently retired as Executive Chairman of Synexus Clinical Research PLC. Michael is Chairman of the Nomination Committee.

### Malcolm Diamond MBE *†•
**Senior Non-Executive Director**
Aged 58, Malcolm joined the Board in August 2000 and is also Chairman of the Remuneration Committee. He is a Non-Executive Director at the Unicorn AIM VCT 11 Investment Fund, and a Senior Non-Executive Director at Centurion Electronics Group plc. His other directorships include Chairman at CWO Limited and My Marketing Limited. In addition, Malcolm advises a number of private businesses on their strategic planning, management development programmes and marketing initiatives. Malcolm was previously Chief Executive at Trifast plc, a role he held for 18 years.

### Neil Warner BA, FCA, MCT *†•
**Non-Executive Director**
Aged 54, Neil joined the Board in May 2003. He is Finance Director at Chloride Group PLC, a position he has held since 1997. Prior to this, he spent six years at Exel PLC (formerly Ocean Group PLC and acquired by Deutsche Post in December 2005) where he held a number of senior posts in financial planning, treasury and control. He has also held senior positions in Balfour Beatty PLC (formerly BICC Group plc), Alcoa and PricewaterhouseCoopers. Neil is Chairman of the Audit Committee.

* Member of the Audit Committee
† Member of the Remuneration Committee
• Member of the Nomination Committee

Services
Pharmaceuticals

1 Martin Riley
2 Mike Eldred
3 Giles Coley
4 Mike Annice
5 Peter Graham
6 Susan Longhofer
7 Zoe Bamford

## Senior Management

### Martin Riley
**Managing Director, National Veterinary Services**
Aged 43, Martin was appointed Managing Director of National Veterinary Services in 2005. A graduate of the Welsh Agricultural College in Aberystwyth, Martin has extensive knowledge of the animal healthcare and veterinary sectors. Before joining the Group, he previously held several senior positions over an 18 year period with the pharmaceutical manufacturer Merial Animal Health.

### Mike Eldred BA, MBA
**President, US Operations, Dechra Veterinary Products**
Aged 37, Mike was appointed in November 2004 to head up the Group's sales and marketing drive in the United States. He has over 12 years' professional experience in the US animal health sector, having held senior positions in business development, sales and operations at Virbac Corporation, and international marketing and operational positions at Fort Dodge Animal Health. Mike began his career with Sanofi Animal Health where he managed the pharmaceutical and biological production planning activities.

### Giles Coley BSc
**Managing Director, Arnolds Veterinary Products and Dechra Veterinary Products UK**
Aged 45, Giles joined Arnolds in 1999 as Sales & Marketing Manager. He took over the role of Managing Director from Ed Torr in October 2003. Prior to this, Giles spent 14 years with Genus (formerly MMB) in various management roles in agricultural business consultancy. He holds a BSc in Agricultural Technology gained at Harper Adams University and is one of the industry representatives on the NOAH (National Office of Animal Health) Veterinary Code of Practice.

### Mike Annice BSc (Hons), MRPharmS
**Managing Director, Dales Pharmaceuticals**
Aged 47, Mike graduated from The School of Pharmacy at Aston University in 1980. Prior to joining Dales in 1990 as Site Manager, he worked within the Hospital Pharmacy Service, Glaxo and SSS International (formerly Cupal Pharmaceuticals). He was appointed Technical Director at the time of the Group's MBO. Mike was appointed Managing Director at Dales in March 2002.

### Dr Peter Graham BVMS, PhD, CertVR, DipECVCP, MRCVS
**Managing Director of NationWide Laboratories and Cambridge Specialist Laboratory Services**
Aged 39, Peter was appointed Managing Director of NationWide Laboratories and Cambridge Specialist Laboratory Services in 2003. Peter graduated from the University of Glasgow Vet School in 1989, where he remained as Small Animal House Physician and Research Scholar until 1995. During this period he was awarded the RCVS Certificate in Veterinary Radiology and a PhD on the Epidemiology and Management of Canine Diabetes Mellitus. He contributed to the initial commercialisation of biochemistry and endocrinology lab services at the University of Glasgow. Between 1995 and 2002, Peter was Assistant Professor at the world's largest specialist veterinary endocrinology laboratory in Michigan State University, USA, leading it as Section Chief from 2000. He was awarded Diplomate of the European College of Veterinary Clinical Pathologists in 2002.

### Dr Susan Longhofer DVM, MS, DipACVIM
**Product Development and Regulatory Affairs Director**
Aged 49, Susan joined the Group in June 2005. She has 18 years' industry experience in development and worldwide registration of animal health pharmaceuticals, having worked for multinational corporations including Virbac Corporation, Heska Corporation and Merck Research Laboratories. Her veterinary degree is from Texas A&M University and her MS is from the University of Wisconsin, Madison. She was awarded Diplomate status in the American College of Veterinary Internal Medicine in 1992. She has a number of Academic and Professional Honours including membership on the Board of Directors of the American Heartworm Society and the Executive Council of the American Academy of Veterinary Pharmacology and Therapeutics.

**Company Secretary**

### Zoe Bamford LLB (Hons)
**Company Secretary and Solicitor**
Aged 33, Zoe was appointed as Company Secretary in July 2007. She qualified as a solicitor in April 2000. Prior to joining Dechra she worked at Eversheds LLP and Brammer plc.

# Directors' Report

The Directors present their Annual Report and Audited Financial Statements for the year ended 30 June 2007.

## Principal Activity

The Group manufactures and sells pharmaceuticals and also markets and sells veterinary equipment and related services including computer systems, predominantly to the UK veterinary market, but also to overseas markets. The Company acts as a holding company to all Group subsidiaries.

## Share Capital

Details of the changes in share capital are shown in note 21 to the financial statements.

## Results and Dividends

The results for the year and financial position at 30 June 2007 are shown in the consolidated income statement on page 38 and balance sheet on page 39. The Directors recommend the payment of a final dividend of 5p per share which, if approved by shareholders, will be paid on 23 November 2007 to shareholders registered at 26 October 2007. An interim dividend of 2.5p per share was paid on 10 April 2007, making a total dividend for the year of 7.5p (2006: 6.24p). The total dividend payment is £3,957,000 (2006: £3,231,000).

## Business Review and Future Developments

A review of the Group's activities during the year and likely future developments are dealt with in the Chairman's Statement on page 4 and the Directors' Business Review on pages 6 to 21.

## Directors

The Directors who held office throughout the year were as follows:

M. Redmond (Chairman)
I.D. Page
S.D. Evans
E.T.W. Torr
M.M. Diamond
N.W. Warner

The interests of the Directors in the share capital of the Company are shown in the Remuneration Report on pages 30 to 33. During the year, no Director had a disclosable material interest in any contract or arrangement with the Company or any of its subsidiaries.

The Company's Articles of Association require one-third of the Company's Directors to retire by rotation at the Annual General Meeting and also if they have held office for more than thirty-six months since appointed or last elected. E.T.W. Torr and M. Redmond retire by rotation and, being eligible, offer themselves for re-election. Biographical details of the Directors can be found on page 22 of this report and accounts.

## Political and Charitable Contributions

Charitable donations made during the year amounted to £750 (2006: Nil). No political donations were made during the year (2006: Nil).

## Research and Development

The Group has a structured research and development programme with the aim of identifying and bringing to market new pharmaceutical products. Investment in research and development is seen as key to further strengthen the Group's competitive position. The expense on this activity for the year ended 30 June 2007 was £1,645,000 (2006: £1,378,000) and a further £1,680,000 less £52,000 amortisation (2006: £195,000 less £60,000 amortisation) was capitalised as development costs.

## Employees

The Group has a policy of offering equal opportunities to employees at all levels in respect of conditions of work. Throughout the Group it is the intention of the Directors to provide possible employment opportunities and training for disabled people and employees who become disabled, having due regard to aptitude and abilities. Further details can be found in the Social, Ethical and Environmental Responsibilities Statement on page 34.

## Acquisitions

On 26 April 2007, the Group acquired Leeds Veterinary Laboratories Limited, thereby extending the Group's laboratory business.

On 14 May 2007 the Group secured a long-term trademark license and supply agreement with Pharmaderm Animal Health. The agreement provides the Group with exclusive marketing and distribution rights for a range of veterinary licensed products and the opportunity to develop new veterinary licences for both North America and Europe.

## Suppliers

The Company does not follow any code of practice or standard regarding the payment of suppliers but seeks to agree the terms of payment with suppliers prior to the placing of business and it is the Company's policy to settle liabilities by the due date. At 30 June 2007, the Group had an average of 74 days (2006: 77 days) purchases outstanding in creditors. The Company had an average of Nil days (2006: Nil days) purchases outstanding in creditors.

### Substantial Shareholdings

As at 21 August 2007, the Company had been notified of the following interests amounting to more than 3% of the issued share capital of the Company:

| | No. of Shares | % of Shares Held |
|---|---|---|
| Schroder Investment Management | 6,858,813 | 12.99 |
| Insight Investment Management | 4,551,314 | 8.62 |
| Legal & General Investment Management | 3,849,888 | 7.29 |
| Rathbone Unit Trust Management | 3,378,620 | 6.40 |
| Barclays Global Investors | 3,840,488 | 7.27 |
| Newton Investment Management | 2,295,450 | 4.34 |
| Invesco Asset Management | 2,150,942 | 4.07 |
| Credit Suisse Asset Management | 1,757,350 | 3.33 |
| OLIM Ltd | 1,792,773 | 3.39 |

### Audit Information

The Directors who held office at the date of the approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware, and each Director has taken all the steps that he ought to have undertaken as a Director to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

### Auditors

A resolution to reappoint KPMG Audit Plc as auditors is to be proposed at the forthcoming Annual General Meeting.

### Statement of Directors' Responsibilities in respect of the Annual Report and the Financial Statements

The statement of Directors' Responsibilities in respect of the Annual Report and the Financial Statements can be found on page 35.

### Directors' and Officers' Liability

The Company maintains an appropriate level of Directors' and Officers' insurance whereby Directors are indemnified against liabilities to third parties to the extent permitted by the Companies Act. The Directors also benefited from qualifying third party indemnity provisions in place during the financial year and at the date of this report.

### Annual General Meeting

The 2007 Annual General Meeting of the Company will be held at 10.00 am on 17 October 2007. In accordance with the Combined Code the notice of the meeting together with the Annual Report and financial statements are posted to shareholders at least 20 working days before the Annual General Meeting. The package sent to shareholders includes a summary of the business to be covered at the Annual General Meeting, where a separate resolution is prepared for each substantive matter. Where a vote is taken on a show of hands, the level of proxies received for and against the resolution and any abstentions are disclosed at the meeting and made available as soon as reasonably practicable after the meeting on the Company website at www.dechra.com.

In addition to the adoption of the 2006/2007 report and accounts, resolutions dealing with the re-election of Directors and the resolution dealing with the approval of the Directors' Remuneration Report, there are five other matters which will be considered at the Annual General Meeting. These relate to the reappointment of KPMG Audit Plc as auditors, declaration of the final dividend, the ability for the Directors to unconditionally allot shares up to one-third of the Company's issued share capital plus share option schemes, the disapplication of pre-exemption rights in relation to the previous resolution and to empower the Company to buy back up to 5% of its issued share capital.

By order of the Board

**Zoe Bamford**
Company Secretary
Dechra Pharmaceuticals PLC
4 September 2007

# Corporate Governance

The Board recognises its accountability to shareholders and is committed to maintaining high standards of corporate governance. In the opinion of the Directors, the Company has complied throughout the period under review with Section 1 of the July 2003 FRC Combined Code on Corporate Governance (the Combined Code) in all aspects apart from:

- M. Redmond's membership of the Remuneration and Audit Committees during the year.

However, M. Redmond's membership of the Remuneration Committee would not be deemed a breach of the updated version of the Combined Code issued in June 2006 which applies to reporting years beginning on or after 1 November 2006 which the Company has voluntarily complied with throughout the year.

The Board considers that M. Redmond should continue his membership of the Audit Committee as he has wide experience and knowledge gained through his directorships with other companies.

### Application of the principles of the Combined Code

Section 1 of the Combined Code sets out the main and supporting principles of good governance for companies. The following report details how the Company has applied the principles of Section 1 of the Combined Code to its activities.

## DIRECTORS

### The Board

The Board is scheduled to meet eleven times per annum with additional meetings called if necessary, including two meetings where the full year and half year results are dealt with.

There is a formal schedule of matters reserved to the Board. These include the approval of corporate policies, strategy, plans and budgets, acquisitions and disposals of companies or businesses; major investment and financial decisions and major management or organisational changes.

At all Board meetings an agenda is established reflecting the Directors' responsibilities. This comprises reports from the Chief Executive, Finance Director, Development Director and Operating Company Directors, reports on the performance of the business, major items of strategic planning, investments and significant policy issues. The Board considers at least annually the strategic plans of the Group and individual businesses. Periodically, the Directors receive presentations from management concerning key areas of the Group's operations.

The Board has formally delegated specific responsibilities to Board Committees, including the Audit, Remuneration and Nomination Committees. The Board will also appoint committees to approve specific processes as deemed necessary.

Attendance at meetings during the year to 30 June 2007 was as follows:

| Name | Board (11 meetings) | Audit (3 meetings) | Remuneration (3 meetings) | Nomination (1 meeting) |
|---|---|---|---|---|
| Michael Redmond | 11 | 3 | 3 | 1 |
| Malcolm Diamond | 11 | 3 | 3 | 1 |
| Neil Warner | 10 | 3 | 3 | 1 |
| Ian Page | 11 | n/a | n/a | 1 |
| Simon Evans | 11 | n/a | n/a | n/a |
| Ed Torr | 11 | n/a | n/a | n/a |

Note: n/a denotes that the Director is not a member of this committee, but may attend by invitation of the committee.

The Chairman regularly holds meetings with the Non-Executive Directors without the Executive Directors being present. Led by the Senior Independent Director, the Non-Executive Directors meet without the Chairman present, at least annually, to appraise the Chairman's performance.

Should Directors have any concerns which cannot be resolved about the running of the Company or a proposed action, they have the right to ensure this is recorded in the minutes. Further, on resignation, should a Non-Executive Director have any concerns, the Chairman would invite him to provide a written statement for circulation to the Board.

The Company maintains an appropriate level of Directors' and Officers' insurance in respect of legal action against directors.

### Chairman and Chief Executive

There is a clear division of responsibilities between the Chairman and Chief Executive. The Chairman is responsible for the leadership and effective working of the Board and to ensure that each Director, in particular the Non-Executive Directors, are able to make an effective contribution to the Board. The Chief Executive is responsible for the management of the Company, implementing policies and strategies determined by the Board. The Board have approved written terms of reference for the Chairman and the Chief Executive.

### Board Balance and Independence

The Board consists of the Non-Executive Chairman, two other Non-Executive Directors and three Executive Directors (including the Chief Executive). The Board considers it is of sufficient size for the discharge of its duties and that the balance of skills and expertise is appropriate for the requirements of the business. The details of the Board of Directors are shown on page 22 and in the Directors' Report on page 24.

The Board considers M.M. Diamond to be the Senior Independent Director and he is available to shareholders if they have concerns which contact through the normal channels have failed to resolve or for which such contact is inappropriate.

The Board considers that all the Non-Executive Directors are independent of management and free of any business or other relationship which could materially interfere with or compromise the exercise of their independent judgement.

### Appointments to the Board

The Nomination Committee comprises M. Redmond (Chairman), M.M. Diamond, N.W. Warner and I.D. Page. The Chairman will not chair the Committee meeting when it is dealing with the appointment of a successor to the Chairman.

The Nomination Committee normally meets once a year and leads the process for Board appointments and making such recommendations to the Board. The terms of reference of the Nomination Committee are available on the Company website at www.dechra.com.

The terms of reference set out the Nomination Committee's role and the authority delegated to it by the Board. They include the following responsibilities:

- To oversee the plans for management succession;
- To recommend appointments to the Board;
- To evaluate the effectiveness of the Non-Executive Directors;
- To consider the structure, size and composition of the Board generally.

There have been no appointments to the Board during the year to 30 June 2007.

### Information and Professional Development

All newly appointed Directors receive an induction programme to the Company including corporate governance training and background to the Company. All Directors are encouraged to keep up to date on all matters relevant to the Group and attend briefings and seminars as appropriate.

Each Director is entitled on request to receive information to enable him to make informed judgements and adequately discharge his duties. In addition, all Directors have access to the advice and services of the Company Secretary and senior managers generally, and may take independent professional advice at the Company's expense in connection with their duties. The Company Secretary is responsible to the Board for ensuring that Board procedures are followed and that applicable rules and regulations are complied with. Both the appointment and removal of the Company Secretary is a matter for the Board as a whole.

### Performance Evaluation

The Board has developed a formal process of reviewing its own effectiveness and the effectiveness of the Board Committees. This is based on a combination of written reviews by individual Directors, discussion with the Chairman and review by the Board as a whole. As part of this process the Board considers the performance of individual Directors. This process has been undertaken during the year.

### Re-election

On appointment, the Directors are required to seek election at the first Annual General Meeting following appointment. One-third of the Board are required to retire from office by rotation at the Annual General Meeting subject to all Directors having submitted themselves for re-election every three years. At the forthcoming Annual General Meeting E.T.W. Torr and M. Redmond retire by rotation in accordance with the Articles of Association. The Board strongly supports their re-election. M. Redmond has served on the Board for more than six years and in line with the Combined Code the Nomination Committee has rigorously reviewed his appointment. The Board considers that he remains independent and that he continues to fulfil his role to the highest standard, providing appropriate support and direction to the Company and its Executives.

## REMUNERATION

Details of Directors' remuneration are set out in the Directors' Remuneration Report at pages 30 to 33. This details the Company's compliance with the Combined Code's requirement with regard to remuneration matters. The terms of reference of the Remuneration Committee are available on the Company website at www.dechra.com.

## ACCOUNTABILITY AND AUDIT

### Financial Reporting

The Board seeks to present a balanced and understandable assessment of the Group's position and prospects, through the Chairman's Statement, the Directors' Business Review and the Directors' Report.

### Internal Control

The Directors are responsible for maintaining the Group's system of internal control, and for reviewing its effectiveness. The system of internal control aims to safeguard the Company's assets, ensure that proper accounting records are maintained, ensure compliance with statutory and regulatory requirements and ensure the effectiveness and efficiency of operations including the assessment and management of risk. The system of internal control is designed to manage rather than eliminate risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance, particularly against material misstatement
or loss.

The Group has a well-established, ongoing and embedded framework of internal financial and operational control for identifying, evaluating and managing the risks faced by the Group. This framework has been in place throughout the year under review, and has continued up to the date of approval of the Annual Report.

In complying with the internal control requirements of the Combined Code, the Directors have taken guidance from the Institute of Chartered Accountants in England and Wales publication "Internal Control: Guidance for Directors on the Combined Code" (the Turnbull Guidance). As a result, the Board prepares and updates a quarterly thorough review of relevant risk areas and systems of internal control. The review is structured by business area and key risk strategy and is based upon a summary of information prepared and reviewed by divisional management on an ongoing basis. The current review was prepared to 30 June 2007.

The Group's key systems of control include:

#### Business Plans

Business plans provide a framework from which annual budgets and forecasts are agreed with each business unit, including financial and strategic targets against which business performance is monitored. The plans are reviewed by executive management, and then by the Board for ultimate approval. Actual performance during the year is monitored monthly against budget, forecast and previous year. Full year forecasts are updated at regular intervals during the year based on trended historical data and realistic forecasts.

#### Investment Approval

The Group has clear requirements for the approval and control of expenditure. Strategic investment decisions involving both capital and revenue expenditure are subject to formal detailed appraisal and review according to approval levels set by the Board. Operating expenditure is controlled within each business with approval levels for such expenditure determined by the individual businesses.

# Corporate Governance continued

### Management Structure

Executive management are responsible for the identification, evaluation and management of the significant risks applicable to their business areas. The risks are assessed on a periodic basis and may be associated with a variety of internal and external sources.

The Company and its business units operate control procedures designed to ensure complete and accurate accounting of financial transactions and to limit the loss of assets due to fraud. Measures taken include physical controls, segregation of duties in key areas, and internal reviews and checks.

Key functions such as tax, treasury, insurance, legal and personnel are controlled centrally.

### Audit Committee and Auditors

Information relating to the Audit Committee is set out in the Audit Committee Report on page 29. This details the Company's compliance with the Combined Code's requirements in respect of audit matters. The terms of reference of the Audit Committee are available on the Company website at www.dechra.com.

Responsibility for monitoring the Group's system of internal control rests with the Board. It is assisted by the Audit Committee, which reviews the interim and annual reports provided to shareholders, the audit process and the systems of internal control and risk management, the latter by way of consideration of the Board's updated progress report and action plan regarding internal controls.

Whilst the Board recognises this does not constitute an internal audit function, it believes that due to the size of the Group this review provides sufficient comfort as to the controls in place. The Audit Committee reviews the requirement for an internal audit function annually.

The Board has reviewed the effectiveness of the Group's internal control systems for the period from 1 July 2006 to the date of approval of the financial statements which has included quarterly business risk reviews and quarterly internal control reporting .

The Board reviews the operation and effectiveness of its control assessment on a regular basis.

The external auditors are engaged to express an opinion of the Company's Annual Report and Accounts. They independently and objectively review management's reporting of the Group's consolidated results and financial position. In addition, they review the systems of internal control and the data contained in the Annual Report and Accounts to the level necessary for expressing their audit opinion.

## RELATIONS WITH SHAREHOLDERS

### Dialogue with institutional shareholders

Relationships with shareholders receive high priority and a rolling programme of meetings between institutional shareholders and Executive Directors is held throughout the year. These meetings are in addition to the annual and interim results presentations and the Annual General Meeting and seek to foster mutual understanding of the Company's and shareholders' objectives. M. Redmond (Chairman) attended a number of the annual results presentations. Such meetings are conducted so as to ensure protection of share price sensitive information that has not already been made generally available to the Company's shareholders. Similar guidelines also apply to communications between the Company and parties such as financial analysts, brokers and the press. The Company also organises site visits on a periodic basis.

### Constructive use of the Annual General Meeting

All members of the Board usually attend the Annual General Meeting. The Chairmen of the Audit Committee, Remuneration Committee and Nomination Committee will normally be available to answer shareholders' questions at that meeting.

Notice of the meeting, together with the Annual Report and financial statements, is posted to shareholders not less than 20 working days prior to the date of the Annual General Meeting. The information sent to shareholders includes a summary of the business to be covered at the Annual General Meeting, where a separate resolution is prepared for each substantive matter. When a vote is taken on a show of hands, the level of proxies received for and against the resolution and any abstentions are disclosed at the meeting and will be made available as soon as practicable after the meeting on the Company website at www.dechra.com.

At the Annual General Meeting there is an opportunity, following the formal business, for informal communications between investors and Directors.

### Going Concern

After consideration of budgets and other financial information, the Directors are satisfied that the Group is in a sound financial position with adequate resources to continue in operation for the foreseeable future. For this reason, the Group's financial statements have been prepared on the basis that the Group is a going concern.

# Audit Committee Report



## Membership

The members of the Audit Committee (the Committee) are currently:

N.W. Warner (Chairman of the Committee)
M. Redmond (Chairman of the Company)
M.M. Diamond (Senior Independent Director)

The Board considers that N.W. Warner has recent and relevant financial experience gained through his position as Finance Director of Chloride Group PLC.

Attendance at the meetings by the Committee members is detailed within the Corporate Governance report on page 26.

## Responsibilities

The main role and responsibilities of the Committee are set out in the written terms of reference which are available on the Company website at www.dechra.com. The main responsibilities are:

- To monitor the integrity of the financial statements of the Company, reviewing the Annual and Interim Reports in detail to ensure they present a balanced assessment of the Company's position and prospects which is understandable to shareholders and potential investors;
- To review the effectiveness of the Company's internal controls and risk management systems as described on pages 27 and 28 and, in conjunction with the auditors, consider the accounting policies adopted by the Company;
- To review the Company's whistle-blowing arrangements;
- To oversee the relationship with the external auditors. The Committee makes recommendations to the Board on the appointment of the external auditors, approves their remuneration, monitors their independence and objectivity, and monitors the effectiveness of the audit process and sets the policy for non-audit work;
- To make recommendations to the Board on the requirement for an internal audit function.

The Committee monitors and reviews the effectiveness of internal control activities. Given the systems of internal control discussed on pages 27 and 28, and due to the present size of the Group, the Committee currently believes that an internal audit function is not required.

## Meetings

The Committee met three times during the year: July, August and February. At the meeting in July the Committee considered the approach and overall scope of the audit to be commenced in respect of the 2006 year end.

A further Committee meeting was held in August which was primarily concerned with the draft financial statements; however, the Committee also considered, amongst other matters, the draft preliminary statement, a review of internal controls and auditor effectiveness.

At the meeting in February, in addition to routine matters the Committee also considered the interim results and draft interim announcement.

The external auditors attend meetings of the Committee other than when their appointment or performance is being reviewed. The Chief Executive, Group Finance Director and other senior finance staff attend as appropriate.

The performance, cost and independence of the external auditors is reviewed annually by the Committee, together with a review of the level of service provided by the external auditors to the Group.

The Committee has discussions at least once a year with the auditors without the management being present.

The scope of the year's audit is discussed in advance by the Committee and audit fees are reviewed and approved by the Committee. Professional rules require rotation of the Group Audit Engagement Director every five years and this took place during the 2006 financial year.

The annual appointment of the auditors by our shareholders at the Annual General Meeting is a fundamental safeguard but, beyond this, controls are in place to ensure that additional work performed by the auditors is appropriate and subject to proper review as discussed below.

## Auditor Independence

With respect to non-audit assignments undertaken by the external auditors, the Company has developed a policy to ensure that the provision of such services does not impair their independence or objectivity. When considering the use of external auditors to undertake non-audit work, the Chief Executive and Group Finance Director do at all times give consideration to the provisions of the Smith Report with regard to the preservation of independence.

The Chief Executive and the Group Finance Director have authority to commission the external auditors to undertake non-audit work where there is a specific project with a cost not exceeding £25,000 and total non-audit fees in any year do not exceed £80,000. This work has to be reported to the Committee at the meeting where the Annual Report is considered. If the cost is expected to exceed the established levels then the prior approval of the Committee is required before the work is commissioned. In all cases, other potential providers are adequately considered.

The external auditors annually confirm their policies on ensuring audit independence and provide the Committee with a report on their own audit quality procedures.

## Effectiveness Review

During the year, the Committee reviewed its own effectiveness through a process led by the Committee Chairman. The results of the review were advised to the Committee and the Board.

Based on the Committee's review of the performance of the external auditors and on the planning and execution of the annual audit, the Committee has recommended to the Board that a resolution to reappoint KPMG Audit Plc be proposed at the forthcoming Annual General Meeting.

**Neil Warner**
Chairman — Audit Committee
4 September 2007

# Directors' Remuneration Report

The Directors' Remuneration Report is presented in accordance with the relevant provisions of the Combined Code and the Directors' Remuneration Report Regulations 2002 (the Regulations). The Regulations require the Company's auditors to report on certain "auditable" information required to be included in the Directors' Remuneration Report. The audited information has therefore been separately highlighted.

The Board is responsible for the Group's remuneration policy and setting Non-Executive fees, although the task of determining and monitoring the remuneration packages of Executive Directors has been delegated to the Remuneration Committee.

## Remuneration Committee (the Committee)

The Committee is responsible for ensuring that the remuneration packages provided to Executive Directors are appropriate to individual levels of experience, responsibility and performance, are consistent with the Company's remuneration policy and are in line with the principles of good corporate governance. The Committee considers remuneration packages payable to Executives at comparable companies when setting the remuneration of Executive Directors and also considers pay structures around the Group.

The Committee comprises solely Non-Executive Directors: M.M. Diamond, M. Redmond and N.W. Warner. The Committee meetings are chaired by M.M. Diamond and met three times during the year. The Chief Executive attended all of these meetings in order to assist on matters concerning remuneration of other senior executives within the Group. The Chief Executive was not present during the part of the meetings where his own remuneration was discussed.

The attendance record of the members is shown on page 26.

During the year, the Committee received advice from New Bridge Street Consultants LLP on executive remuneration, pensions and other benefits.

## Remuneration Policy

The Company's policy on Directors' remuneration for the forthcoming year is that its remuneration packages should be capable of attracting, rewarding and retaining Executive Directors whilst being arrived at responsibly and fairly, when compared with similar organisations.

The remuneration packages of Executive Directors are structured to include a performance related element linked to corporate and individual objectives. Both the Executive Incentive Plan and the Executive Bonus Scheme are performance related. Bonuses are non-pensionable.

Remuneration for Non-Executive Directors is limited to salary only with no performance related element.

The Company's policy on the remuneration of all Directors is reviewed annually.

Once remuneration has been approved by the Board, the Chairman of the Committee, where considered appropriate, will consult the Company's principal shareholders regarding remuneration issues. This Remuneration Report is included in the Annual General Meeting agenda for shareholder approval.

## Components of the Remuneration Package

### Basic Salary

The basic salary of each Executive Director is reviewed annually and is determined taking into account the responsibilities and performance of the individual, together with independently furnished information on rates for similar positions in comparable industry sectors. Details of salaries, bonuses and benefits paid to Executive Directors during the year ended 30 June 2007 are included in the table headed "Summary of Remuneration" shown on page 32. The current basic annual salaries of the Executive Directors with effect from 1 July 2007 are: I.D. Page £300,000, S.D. Evans £175,000, E.T.W. Torr £160,000.

### Benefits in kind

Executive Directors receive other benefits, including the use of a fully expensed car, medical cover and life insurance. This provides an overall package that is competitive with similar companies.

### Pensions

The Company operates a Group Stakeholder personal pension scheme which has been effective since 1 July 2005. The previous pension scheme was closed on 25 July 2006, all contributions having been transferred to an S32a contract.

### Share Option Schemes

The Company operates the Approved Share Option Scheme, the Unapproved Share Option Scheme together with a savings related share option scheme (SAYE Scheme). Executive Directors are entitled to participate in the SAYE Scheme and the Executive Incentive Plan discussed below. However, Executive Directors are not entitled to participate in either the Approved Share Option Scheme or the Unapproved Share Option Scheme. The table on page 33 provides an analysis of outstanding Directors' SAYE Share Options.

### Executive Incentive Plan

Following its approval by shareholders at the Annual General Meeting on 23 October 2003, the Company operates the Executive Incentive Plan for Executive Directors and other key employees.

The Executive Incentive Plan aims to provide a clear link between the remuneration of Executive Directors and the creation of value for shareholders by rewarding Executive Directors for the Company's performance in terms of Total Shareholder Return ("TSR").

Under this plan, the Committee makes awards to Senior Executives of shares in the Company, with vesting to individuals being subject to the achievement of performance targets. The target is based on TSR over a three year measurement period (commencing at the beginning of the financial year in which the awards are made) expressed as an annual percentage return over that period. The TSR is calculated and compared to the TSRs of all other companies in the FTSE Small Cap Index for the entire measurement period. If the Company is ranked in the top quartile of the list of TSRs achieved by the companies in the FTSE Small Cap Index over the measurement period, all of the shares over which an award had been made will vest.

If the TSR of the Company is ranked in the second quartile then the number of shares which will vest is determined by reference to a straight-line graph which ensures that 30% of the shares over which the award has been made will vest on the achievement of a TSR that places the Company at the bottom of the second quartile and all of the shares will vest on an achievement of a TSR that places the Company at the top of the second quartile.

If the TSR of the Company is ranked in the third or fourth quartile then none of the shares over which an award had been made will vest and the relevant participant will not be entitled to any of the shares.

In addition to the TSR performance target, no award will vest unless, in the opinion of the Committee, the underlying financial performance of the Company has been satisfactory over the measurement period.

Initial awards granted under the Executive Incentive Plan were made during the year ended 30 June 2004; the measurement period for these awards commenced on 1 July 2003 and ended on 30 June 2006. In accordance with the rules of the Executive Incentive Plan, awards granted since the initial award are limited to 50% of basic salary. The measurement period for the grants made during this financial year commenced on 1 July 2006 and ends on 30 June 2009.

During the year the initial awards vested. Calculation of the performance target confirmed that the Company's TSR performance for the three year period to 30 June 2006 was in the top quartile of the FTSE small cap comparator group of companies. The full award was therefore exercisable in accordance with the rules of the Executive Incentive Plan.

The table on page 33 provides an analysis of the Executive Incentive Plan.

### Executive Bonus Scheme

The Executive Bonus Scheme rewards Executive Directors for achieving operating efficiencies and profitable growth in the relevant year by reference to challenging, but achievable operational performance targets derived at the beginning of the financial year. The bonus is calculated on formulae, which are determined each year by the Remuneration Committee.

Executive bonuses for the year ended 30 June 2007 were calculated as follows:

- 33% of salary payable upon the achievement of 100% of profit target;
- 50% of salary payable upon the achievement of 105% of profit target.

The bonus to be pro-rated on achievement between 100% and 105% of profit target.

Executive bonuses for the year ending 30 June 2008 are to be calculated as follows:

- 10% of salary payable upon the achievement of 95% of profit target;
- 50% of salary payable upon the achievement of 105% of profit target.

The bonus to be pro-rated on achievement between 95% and 105% of profit target.

In respect of both 2007 and 2008, an additional 10% of salary is also payable to Executive Directors upon the achievement of personal objectives. The personal objectives of the Chief Executive were set by the Chairman, and those of the other Executive Directors were set by the Chief Executive. These additional bonuses are payable at the sole discretion of the Committee.

The amount of bonuses payable to Executive Directors in respect of the year ended 30 June 2007 can be found on page 32 under "Summary of Remuneration".

## Contracts of Service

Each Executive Director has a service contract with the Company which contains details regarding remuneration, restrictions and disciplinary matters.

Executive Directors are appointed on contracts terminable by the Company on not more than 12 months' notice and by the Director on 6 months' notice.

Non-Executive Directors have a service contract for an initial 12 month period which is thereafter terminated by either party giving 12 months' notice. Participation in share option schemes, bonus schemes or entitlement to a pension is not allowed under the service contract.

Details of Directors' service contracts and notice periods are set out below:

| | | Notice Period | |
|---|---|---|---|
| Name | Commencement | Director | Company |
| M. Redmond | 25 April 2001 | 12 months | 12 months |
| I.D. Page | 23 August 2000 | 6 months | 12 months |
| S.D. Evans | 23 August 2000 | 6 months | 12 months |
| E.T.W. Torr | 23 August 2000 | 6 months | 12 months |
| M.M. Diamond | 23 August 2000 | 12 months | 12 months |
| N.W. Warner | 2 May 2003 | 12 months | 12 months |

There are no expiry dates applicable to either Executive or Non-Executive Directors' service contracts.

The Company may, in its absolute discretion at any time after written notice of termination has been given by either party, lawfully terminate the service contract by paying to the Director an amount equal to his salary entitlement for the unexpired period of notice together with an amount representing the fair value of any other benefits to which the Director is contractually entitled for the unexpired period of notice (subject in either case to a deduction at source of income tax and national insurance contributions).

In the event that the service contract is terminated partway through any financial year, the Director shall not be entitled to any bonus in respect of that financial year.

Non-Executive Directors' compensation is confined to 12 months' remuneration.

# Directors' Remuneration Report continued

Individual Directors' eligibility for the various elements of compensation is set out below:

| Name | Salary | Bonus | Benefits |
|---|---|---|---|
| M. Redmond | 12 months | n/a | n/a |
| I.D. Page | 12 months | Nil | 12 months |
| S.D. Evans | 12 months | Nil | 12 months |
| E.T.W. Torr | 12 months | Nil | 12 months |
| M.M. Diamond | 12 months | n/a | n/a |
| N.W. Warner | 12 months | n/a | n/a |

Where applicable, payment of this compensation would be in full and final settlement of all claims other than in respect of share options and pension arrangements.

In an appropriate case the Directors would have a regard to the departing Director's duty to mitigate loss, except in the event of dismissal following a change of control of the Company.

Other than as described above, there are no express provisions within the Directors' service contracts for the payment of compensation or liquidated damages on termination of employment.

No awards of compensation for loss of office or any other reason have been made to any person, whether a Director or a former Director, during the year.

No compensation payments were made to Executive or Non-Executive Directors during the year.

## Directors' Shareholdings

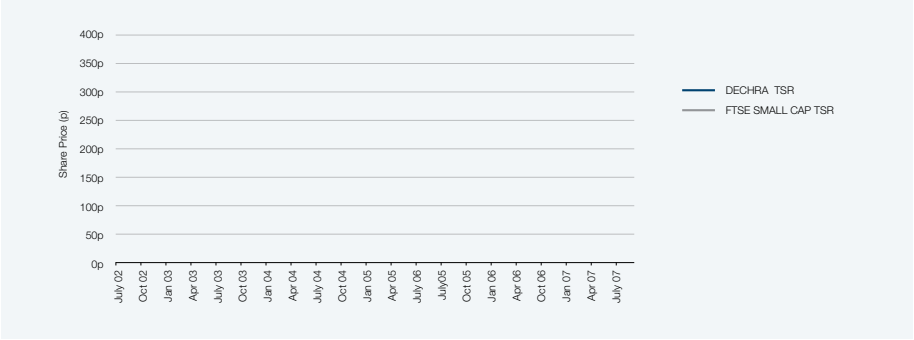
The beneficial interests of the Directors in office and their families in the share capital of Dechra Pharmaceuticals PLC as at 30 June 2007 were as follows:

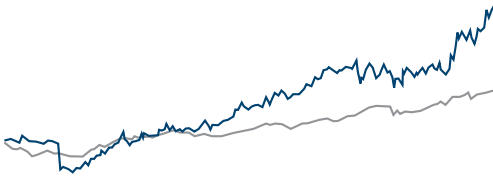
| Shareholdings | Ordinary Shares 2007 | Ordinary Shares 2006 |
|---|---|---|
| M. Redmond | **35,000** | 35,000 |
| I.D. Page | **662,819** | 592,167 |
| S.D. Evans | **749,131** | 669,131 |
| E.T.W. Torr | **390,934** | 343,832 |
| M.M. Diamond | **5,000** | 5,000 |
| N.W. Warner | **2,206** | 2,206 |

There have been no changes in the holdings of the Directors between 30 June and 21 August 2007.

## Total Shareholder Return

The graph below shows the total shareholder return performance of the Company over the past five years compared with the total shareholder return over the same period for the FTSE Small Cap Total Return Index. The FTSE Small Cap Index is considered to be an appropriate index as the Company is a constituent of that index.



## Effectiveness Review

During the year, the Committee reviewed its effectiveness through a process led by the Committee Chairman. The findings were reported to the Committee and the Board.

## Audited Information

The auditors are required to report on the information contained in the remainder of this report.

## Summary of Remuneration

| | Salaries & Fees £'000 | Bonuses £'000 | Other Benefits £'000 | Total 2007 £'000 | Total 2006 £'000 |
|---|---|---|---|---|---|
| **Executive Directors** | | | | | |
| I.D. Page (Chief Executive) | 235 | 130 | 24 | **389** | 269 |
| S.D. Evans | 150 | 83 | 23 | **256** | 169 |
| E.T.W. Torr | 140 | 78 | 15 | **233** | 164 |
| **Non-Executive Directors** | | | | | |
| M. Redmond (Chairman) | 52 | — | — | **52** | 46 |
| M.M. Diamond | 29 | — | — | **29** | 26 |
| N.W. Warner | 27 | — | — | **27** | 24 |
| | 633 | 291 | 62 | **986** | 698 |

## Executive Incentive Plan

Awards made under the Executive Incentive Plan are as follows:

| | Award date | Number of shares at 30 June 2006 | Granted during the year | Exercised during the year | **Number of shares at 30 June 2007** | Performance period | Share Price at date of award pence | Share Price at date of exercise pence |
|---|---|---|---|---|---|---|---|---|
| I.D. Page | 2003 | 120,000 | — | (120,000) | **—** | 2003–2006 | 126 | 248 |
| | 2004 | 48,589 | — | — | **48,589** | 2004–2007 | 159.5 | — |
| | 2005 | 34,861 | — | — | **34,861** | 2005–2008 | 251 | — |
| | 2006 | — | 47,412 | — | **47,412** | 2006–2009 | 250.75 | — |
| | | 203,450 | 47,412 | (120,000) | **130,862** | | | |
| S.D. Evans | 2003 | 80,000 | — | (80,000) | **—** | 2003–2006 | 126 | 248 |
| | 2004 | 33,096 | — | — | **33,096** | 2004–2007 | 159.5 | — |
| | 2005 | 23,904 | — | — | **23,904** | 2005–2008 | 251 | — |
| | 2006 | — | 30,263 | — | **30,263** | 2006–2009 | 250.75 | — |
| | | 137,000 | 30,263 | (80,000) | **87,263** | | | |
| E.T.W. Torr | 2003 | 80,000 | — | (80,000) | **—** | 2003–2006 | 126 | 248 |
| | 2004 | 31,348 | — | — | **31,348** | 2004–2007 | 159.5 | — |
| | 2005 | 22,908 | — | — | **22,908** | 2005–2008 | 251 | — |
| | 2006 | — | 28,245 | — | **28,245** | 2006–2009 | 250.75 | — |
| | | 134,256 | 28,245 | (80,000) | **82,501** | | | |

## SAYE Scheme

Directors' entitlements under the SAYE Scheme are as follows:

| | Award date | Market price at date of grant pence | Exercise price pence | Exercise dates | At 30 June 2006 number | Exercised number | Granted number | Lapsed number | **At 30 June 2007 number** |
|---|---|---|---|---|---|---|---|---|---|
| I.D. Page | 2 April 2003 | 48 | 39 | June 2008 | 42,115 | — | — | — | **42,115** |
| S.D. Evans | 15 October 2004 | 198 | 158 | Jan 2008 | 7,641 | — | — | — | **7,641** |
| E.T.W. Torr | 15 October 2004 | 198 | 158 | Jan 2008 | 3,056 | — | — | — | **3,056** |
| | 18 October 2005 | 255 | 204 | Dec 2008 | 2,750 | — | — | — | **2,750** |
| | | | | | 55,562 | — | — | — | **55,562** |

The middle market price for the Company's shares on 29 June 2007 was 348p and the range of prices during the year was 233.5p to 371p.

## Pension Entitlement

All Executive Directors were members of the Dechra Pharmaceutical PLC Group Stakeholder personal pension scheme throughout the year. Contributions made by Dechra Pharmaceuticals PLC on behalf of the Executive Directors during the year are based on a percentage of pensionable salary and were paid as follows:

| | Age | **Contributions 2007 £000** | Contributions 2006 £000 |
|---|---|---|---|
| I.D. Page | 46 | **31** | 21 |
| S.D. Evans | 43 | **20** | 14 |
| E.T.W. Torr | 47 | **18** | 14 |
| | | **69** | 49 |

By order of the Board

**Malcolm Diamond**
Chairman — Remuneration Committee
4 September 2007

# Social, Ethical and Environmental Responsibilities

A responsible approach to our stakeholders and the wider community is seen by the Board to be fundamental to the Group. The conduct of the Group towards social, environmental, ethical and health and safety issues is recognised to have an impact on our reputation and the implementation of policies and systems continues.

The Board takes ultimate responsibility for corporate social responsibility (CSR) and continues to be committed to developing and implementing appropriate policies to create and maintain long-term value for shareholders. Sound business ethics help to minimise risk, ensure legal compliance and enhance company efficiency. The need to review and manage risks to the short and long-term value of the Company arising from CSR is recognised by the Board and it considers that it has received adequate information to review these risks and has not identified any risks to the business that could affect its future value.

## Environmental Policy

The Group recognises the importance of good environmental controls. It is the Group's policy to comply with and exceed environmental legislation currently in place, adopt responsible environmental practices and be committed to minimising the impact of its operations on the environment.

The Group is a registered member of a compliance scheme in respect of the Waste Packaging Obligations Regulations and, in addition, all of the National Veterinary Services depots recycle waste cardboard back to UK paper mills, and waste polythene is also recycled back to UK recycling agents.

A fleet of low $CO_2$ emission diesel vehicles is maintained with these vehicles being replaced every three years via leasing agreements. In addition, a number of LPG powered vehicles are being used in and around the London area.

Our manufacturing unit continues to comply with and better effluent discharge standards into local water supplies, this being monitored by Yorkshire Water Authority. Standard operating procedures are in place to ensure that contaminated waste is disposed of under strict controls. Exhaust air is fully filtered from the manufacturing unit before discharge.

The Group continues to review its environmental controls and encourage its own staff, suppliers and customers to achieve similar standards.

The Development Director is the nominated Director responsible for environmental policies.

## Business Ethics

The Board expects all of the Group's business activities to be conducted in accordance with high standards of ethical conduct and full compliance with all applicable national and international legislation. This includes, in particular, the provision of a safe working environment including health and safety awareness, maintenance of fair and competitive employment practices, opposition to any bribery or corrupt business practices, treating suppliers on a fair basis to build long-term relationships to our mutual benefit, and being responsive for our customers' needs and providing a high standard of customer care.

A "whistle-blowing" policy is in place whereby employees may report, in confidence, any suspected wrongdoings within the business where they feel unable to discuss any such issue directly with local management. This policy is available to all employees via staff handbooks and the Company website at www.dechra.com.

Open and honest communication is positively encouraged between employees and management throughout the business.

## Health and Safety Policy

The Group attaches great importance to the health and safety of its employees and the public. The management are responsible and committed to the maintenance, monitoring and promoting of a policy of Health and Safety at work, to ensure the care and well-being of its employees and on-site visitors. All of its sites are registered with the British Safety Council.

Each unit within the Group has an active Health and Safety Committee comprising representatives from both management and employees. The workforce nominates employee representatives. These committees meet on a regular basis to carry out a review of risk assessments and standard operating procedures as well as investigating any concerns raised by individual employees. Each site has the requisite number of employees trained in Health and Safety legislation.

A full health and safety report is presented at Divisional Board Meetings on a regular basis in the presence of Executive Directors. These reports are summarised for subsequent review by the Board.

A transport risk review committee has been established to assess risks related to the vehicle fleet and establish control procedures. This includes a quarterly licence check of all individuals who are able to drive company vehicles, an investigation into all accidents and a disciplinary procedure for speeding offences. This committee meets six times a year and issues raised by this committee are included at Health and Safety meetings.

The Finance Director is the nominated Director responsible for Health and Safety policy.

## Employees

It is the Group's policy to encourage employee involvement as the Directors consider that this is essential for the successful running of the business. The Group keeps employees informed of performance, developments and progress by way of regular team briefing sessions and notices. The manufacturing site is registered with "Investors in People" and operates a Works Council.

It is the Company's policy to provide equal recruitment and other opportunities for all employees, regardless of age, sex, religion, race or disability. The Group gives full consideration to applications from disabled people, where they adequately fulfil the requirements of the role.

Where existing employees become disabled, it is the Group's policy whenever practicable to provide continuing employment under the Company's terms and conditions and to provide training and career development whenever appropriate.

The Group has encouraged employees to share in the growth of the Company through eligibility to participate in the SAYE Scheme.

# Statement of Directors' Responsibilities in respect of the Annual Report and the Financial Statements

The Directors are responsible for preparing the Annual Report and the Group and Parent Company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and Parent Company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with IFRSs as adopted by the EU and have elected to prepare the Parent Company financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

The Group financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position and the performance of the Group; the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

The Parent Company financial statements are required by law to give a true and fair view of the state of affairs of the Parent Company.

In preparing each of the Group and Parent Company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- for the Group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- for the Parent Company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the Parent Company financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the Parent Company will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Parent Company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities. Under applicable law and regulations, the Directors are also responsible for preparing a Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that comply with that law and those regulations.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

# Independent Auditors' Report to the Members of Dechra Pharmaceuticals PLC

We have audited the Group and Parent Company financial statements (the "financial statements") of Dechra Pharmaceuticals PLC for the year ended 30 June 2007 which comprise the Consolidated Income Statement, the Consolidated and Parent Company Balance Sheets, the Consolidated Statement of Cash Flows, the Consolidated Statement of Changes in Shareholders' Equity and the related notes. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company, and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

## Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report and the Group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU, and for preparing the Parent Company financial statements and the Directors' Remuneration Report in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities on page 35.

Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the Directors' Business Review that is cross-referenced from the Business Review and Future Developments section of the Directors' Report. In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the Company's compliance with the nine provisions of the 2003 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

## Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors' Remuneration Report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Directors' Remuneration Report to be audited.

## Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Group's affairs as at 30 June 2007 and of its profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation;
- the Parent Company financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the Parent Company's affairs as at 30 June 2007;
- the Parent Company financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

**KPMG Audit Plc**
Chartered Accountants
Registered Auditor
4 September 2007

2 Cornwall Street
Birmingham
B3 2DL

# Consolidated Financial Statements

## Contents

# Consolidated Income Statement

| For the year ended 30 June 2007 | Note | 2007 £'000 | 2006 £'000 |
|---|---|---|---|
| **Revenue** | 2 | **253,803** | 232,471 |
| Cost of sales | | **(216,952)** | (199,205) |
| **Gross profit** | | **36,851** | 33,266 |
| Distribution costs | | **(10,850)** | (10,309) |
| Administrative expenses | | **(12,152)** | (10,645) |
| **Operating profit** | 2 | **13,849** | 12,312 |
| Finance income | 3 | **1,044** | 725 |
| Finance expense | 4 | **(2,274)** | (1,993) |
| **Profit before taxation** | 5 | **12,619** | 11,044 |
| Income tax expense | 7 | **(3,772)** | (3,487) |
| **Profit for the year attributable to equity holders of the parent** | | **8,847** | 7,557 |
| Earnings per share (pence) | | | |
| **Basic** | 9 | **16.86p** | 14.71p |
| **Diluted** | 9 | **16.62p** | 14.36p |
| **Dividend per share (interim paid and final proposed for the year)** | 8 | **7.50p** | 6.24p |

# Consolidated Balance Sheet

| At 30 June 2007 | Note | 2007 £'000 | 2006 £'000 |
|---|---|---|---|
| **ASSETS** | | | |
| **Non-current assets** | | | |
| Intangible assets | 10 | **13,089** | 7,527 |
| Property, plant and equipment | 11 | **5,739** | 5,595 |
| Deferred tax assets | 13 | **—** | 445 |
| **Total non-current assets** | | **18,828** | 13,567 |
| **Current assets** | | | |
| Inventories | 14 | **25,732** | 21,957 |
| Trade and other receivables | 15 | **36,173** | 35,347 |
| Cash and cash equivalents | 16 | **17,222** | 19,738 |
| **Total current assets** | | **79,127** | 77,042 |
| **Total assets** | | **97,955** | 90,609 |
| **LIABILITIES** | | | |
| **Current liabilities** | | | |
| Borrowings | 19 | **(4,529)** | (3,417) |
| Trade and other payables | 17 | **(48,641)** | (45,530) |
| Current tax liabilities | 18 | **(2,464)** | (2,505) |
| **Total current liabilities** | | **(55,634)** | (51,452) |
| **Non-current liabilities** | | | |
| Borrowings | 19 | **(11,666)** | (15,242) |
| Deferred tax liabilities | 13 | **(147)** | — |
| **Total non-current liabilities** | | **(11,813)** | (15,242) |
| **Total liabilities** | | **(67,447)** | (66,694) |
| **Net assets** | | **30,508** | 23,915 |
| **EQUITY** | | | |
| Issued share capital | 21 | **528** | 519 |
| Share premium account | | **28,041** | 27,693 |
| Hedging reserve | | **(71)** | (71) |
| Merger reserve | | **1,770** | 1,720 |
| Retained earnings | | **240** | (5,946) |
| **Total equity attributable to equity holders of the parent** | | **30,508** | 23,915 |

The financial statements were approved by the Board of Directors on 4 September 2007 and are signed on its behalf by:

**Ian Page** Director

**Simon Evans** Director

# Consolidated Statement of Changes in Shareholders' Equity

| For the year ended 30 June 2007<br>Year ended 30 June 2006 | Issued share capital £'000 | Share premium account £'000 | Hedging reserve £'000 | Merger reserve £'000 | Retained earnings £'000 | Total £'000 |
|---|---|---|---|---|---|---|
| At 1 July 2005 | 511 | 26,953 | (71) | 1,720 | (11,582) | 17,531 |
| Profit for the period being total recognised income | | | | | | |
| and expense for the period | — | — | — | — | 7,557 | 7,557 |
| Dividends paid | — | — | — | — | (2,777) | (2,777) |
| Share-based payments including current and deferred tax | — | — | — | — | 856 | 856 |
| Shares issued | 8 | 740 | — | — | — | 748 |
| At 30 June 2006 | 519 | 27,693 | (71) | 1,720 | (5,946) | 23,915 |
| **Year ended 30 June 2007** | | | | | | |
| At 1 July 2006 | 519 | 27,693 | (71) | 1,720 | (5,946) | 23,915 |
| Profit for the period being total recognised income | | | | | | |
| and expense for the period | — | — | — | — | 8,847 | 8,847 |
| Dividends paid | — | — | — | — | (3,595) | (3,595) |
| Share-based payments including current and deferred tax | — | — | — | — | 934 | 934 |
| Shares issued | 9 | 348 | — | 50 | — | 407 |
| **At 30 June 2007** | **528** | **28,041** | **(71)** | **1,770** | **240** | **30,508** |

The hedging reserve was created on adoption of IAS 39 on 1 July 2005. As the Group has not adopted hedge accounting under IAS 39 from 1 July 2005 the hedging reserve is frozen and will only be released to the income statement when the related forecast transactions occur. The merger reserve represents the excess of fair value over nominal value of shares issued in consideration for the acquisition of subsidiaries where statutory merger relief has been applied in the financial statements of the Parent Company. The movement in the year ended 30 June 2007 relates to the acquisition of Leeds Veterinary Laboratories Limited.

# Consolidated Statement of Cash Flows



| For the year ended 30 June 2007 | Note | 2007 £'000 | 2006 £'000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Profit for the period | | **8,847** | 7,557 |
| *Adjustments for:* | | | |
| Depreciation | | **984** | 886 |
| Amortisation | | **137** | 136 |
| Gain on sale of property, plant and equipment | | **(7)** | (23) |
| Finance income | | **(1,044)** | (725) |
| Finance expense | | **2,274** | 1,993 |
| Equity-settled share-based payment expenses | | **479** | 427 |
| Income tax expense | | **3,772** | 3,487 |
| **Operating cash flow before changes in working capital** | | **15,442** | 13,738 |
| Increase in inventories | | **(3,737)** | (1,567) |
| Increase in trade and other receivables | | **(248)** | (1,736) |
| Increase in trade and other payables | | **2,871** | 3,562 |
| **Cash generated from operations** | | **14,328** | 13,997 |
| Interest paid | | **(2,228)** | (1,890) |
| Income taxes paid | | **(2,895)** | (2,618) |
| **Net cash from operating activities** | | **9,205** | 9,489 |
| **Cash flows from investing activities** | | | |
| Proceeds from sale of property, plant and equipment | | **23** | 23 |
| Interest received | | **1,059** | 672 |
| Acquisition of subsidiaries | 25 | **(717)** | — |
| Purchase of property, plant and equipment | | **(823)** | (1,320) |
| Capitalised development expenditure | | **(1,680)** | (195) |
| Purchase of other intangible non-current assets | | **(2,845)** | — |
| **Net cash from investing activities** | | **(4,983)** | (820) |
| **Cash flows from financing activities** | | | |
| Proceeds from the issue of share capital | | **357** | 780 |
| New borrowings | | **—** | 705 |
| Repayment of borrowings | | **(3,481)** | (1,582) |
| Dividends paid | | **(3,595)** | (2,777) |
| **Net cash from financing activities** | | **(6,719)** | (2,874) |
| **Net (decrease)/increase in cash and cash equivalents** | | **(2,497)** | 5,795 |
| Cash and cash equivalents at start of period | | **19,719** | 13,924 |
| **Cash and cash equivalents at end of period** | | **17,222** | 19,719 |
| Shown as: | | | |
| Cash and cash equivalents | | **17,222** | 19,738 |
| Bank overdraft | | **—** | (19) |
| | | **17,222** | 19,719 |

# Consolidated Statement of Cash Flows continued

## Reconciliation of net cash to movement in net borrowings

| For the year ended 30 June 2007 | Note | 2007 £'000 | 2006 £'000 |
|---|---|---|---|
| Net (decrease)/increase in cash and cash equivalents | | (2,497) | 5,795 |
| Repayment of borrowings | | 3,481 | 1,582 |
| New borrowings | | — | (705) |
| Borrowings assumed on acquisition of subsidiaries | 25 | (55) | — |
| New finance leases | | (956) | (649) |
| Other non-cash changes | | (25) | (85) |
| **Movement in net cash in the period** | | (52) | 5,938 |
| Net cash/(borrowings) at start of period | | 1,079 | (4,859) |
| **Net cash at end of period** | 23 | 1,027 | 1,079 |

## 1. Accounting Policies

Dechra Pharmaceuticals PLC is a company domiciled in the United Kingdom. The consolidated financial statements of the Group for the year ended 30 June 2007 comprise the Company and its subsidiaries.

### (a) Statement of Compliance

The Consolidated Financial Statements have been prepared and approved by the Directors in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union and with those parts of the Companies Act 1985 applicable to companies reporting under IFRS ("adopted IFRS"). The Company has elected to prepare its Parent Company financial statements in accordance with UK GAAP and they are separately presented on pages 67 to 75.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these Group financial statements.

The Group's significant accounting policies are listed below:

### (b) Basis of Preparation

The financial statements are presented in Sterling, rounded to the nearest thousand. They are prepared on the historical cost basis except for derivative financial instruments and cash-settled share-based transactions that are stated at fair value.

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

IFRS7 'Financial Instruments Disclosure' has not yet been applied. IFRS7 is applicable to years commencing on or after 1 January 2007 and was available for early application but has not yet been adopted by the Group in these financial statements.

The application of IFRS7 in the year to 30 June 2007 would not have affected the income statement or balance sheet as the standard is concerned only with disclosure. The Group plans to adopt it in the year to 30 June 2008.

Additionally, the following interpretations which have not been applied in these financial statements were in issue but not effective:

- IFRIC8 'Scope of IFRS2 Share-based payment' addresses the accounting for share-based payment transactions in which some or all of the goods or services received cannot be specifically identified. IFRIC8, which becomes mandatory for the Group's 2008 financial statements, is not expected to have any impact on the Consolidated Financial Statements.
- IFRIC9 'Reassessment of Embedded Derivatives' requires that a reassessment of whether embedded derivatives should be separated from the underlying host contract should be made only when there are changes to the contract. IFRIC9, which becomes mandatory for the Group's 2008 financial statements, is not expected to have any impact on the Consolidated Financial Statements.
- IFRIC10 'Interim Financial Reporting and Impairment' prohibits the reversal of an impairment loss recognised in a previous interim period in respect of goodwill, an investment in an equity instrument or a financial asset carried at cost. IFRIC10 will become mandatory for the Group's 2008 financial statements and will apply to goodwill from the date that the Group first applied the measurement criteria of IAS36 and IAS39. The adoption of IFRIC10 is not expected to have any impact on the Consolidated Financial Statements.
- IFRIC11 'IFRS2 Share-based payments — Group and Treasury Share Transactions' provides guidance on whether share-based payment arrangements in which employees of a subsidiary are provided with the equity instruments of the parent should be accounted for as equity-settled or cash-settled in the subsidiary's financial statements. It also clarifies that a share-based payment arrangement in which an entity receives goods or services as consideration for its own equity instruments should be accounted for as equity-settled. The IFRIC becomes mandatory for the Group's 2008 financial statements and is not expected to have any impact on the Consolidated Financial Statements.
- IAS1 'Presentation of Financial Statements' requires that disclosure of qualitative and quantitive capital management information is presented. This amendment to IAS1, which becomes mandatory for the Group's 2008 financial statements, will have a disclosure effect only.

### (c) Basis of Consolidation

#### (i) Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the Consolidated Financial Statements from the date that control commences until the date that control ceases.

#### (ii) Transactions Eliminated on Consolidation

Intra-group balances and any unrealised gains and losses or income and expenses arising from intra-group transactions are eliminated in preparing the Consolidated Financial Statements.

## 1. Accounting Policies continued

### (d) Business Combinations

The acquisition of subsidiaries is accounted for using the purchase method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of completion, of assets given, liabilities incurred or assumed, and equity instruments issued by the Company in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's indentifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS3 are recognised at their fair value at the acquisition date.

### (e) Foreign Currency Transactions

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to Sterling at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to Sterling at the foreign exchange rates ruling at the dates the fair value was determined.

### (f) Derivative Financial Instruments

The Group uses derivative financial instruments to manage its exposure to foreign exchange and interest rate risks. In accordance with its treasury policy, the Group does not hold or issue derivative financial instruments for speculative purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

IAS32 and IAS39 were adopted prospectively from 1 July 2005. On this date, the fair values of derivatives used for hedging were included in a hedging reserve. The corresponding adjustments were to decrease trade and other receivables by £58,000, increase trade and other payables by £44,000 and increase the deferred tax asset by £31,000. As the Group has not adopted hedge accounting under IAS39 from 1 July 2005 the hedging reserve is frozen and will only be released to the income statement when the related forecast transactions occur.

Derivative financial instruments are recognised initially at fair value. Subsequent to initial recognition, derivative financial instruments are stated at fair value. The gain or loss on remeasurement to fair value is recognised immediately in the income statement.

The fair value of interest rate swaps, floors and ceilings is the estimated amount that the Group would receive or pay to terminate the instrument at the balance sheet date. The fair value of forward exchange contracts and options is their quoted market price at the balance sheet date, being the present value of the quoted forward price.

### (g) Property, Plant and Equipment

#### (i) Owned Assets

Items of property, plant and equipment are stated at cost less accumulated depreciation (see below) and impairment losses (see accounting policy l).

#### (ii) Leased Assets

Leases under the terms of which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Assets acquired by finance leases are stated at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and impairment losses.

#### (iii) Subsequent Costs

The Group recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Group and the cost of the item can be measured reliably. All other costs are recognised in the income statement as an expense as incurred.

#### (iv) Depreciation

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Land is not depreciated. Assets in the course of construction are not depreciated until the date the assets become available for use. The estimated useful lives are as follows:

| | |
|---|---|
| short leasehold buildings | period of lease |
| plant and fixtures | 10%–33 1/3% |
| motor vehicles | 25% |

The residual value, if not insignificant, is reassessed annually.

### (h) Intangible Assets

#### (i) Goodwill

All business combinations are accounted for by applying the purchase method. Goodwill represents amounts arising on acquisition of subsidiaries, associates and joint ventures. In respect of business acquisitions that have occurred since 1 July 2004, goodwill represents the difference between the cost of the acquisition and the fair value of the net identifiable assets acquired.

In respect of acquisitions prior to this date, goodwill is included on the basis of its deemed cost, which represents the amount recorded under previous GAAP. The classification and accounting treatment of business combinations that occurred prior to 1 July 2004 were not reconsidered in preparing the Group's opening IFRS balance sheet at 1 July 2004.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is not amortised but is allocated to cash generating units and is tested annually for impairment.

## 1. Accounting Policies continued

### (ii) Research and Development Costs

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognised in the income statement as an expense is incurred.

The Group is also engaged in development activity with a view to bringing new pharmaceutical products to market. Internally generated costs of development are capitalised in the balance sheet unless those costs cannot be measured reliably or it is not probable that future economic benefits will flow to the Group, in which case the relevant costs are expensed to the income statement as incurred. Due to the strict regulatory process involved, there is inherent uncertainty as to the technical feasibility of development projects often until regulatory approval is achieved, with the possibility of failure even at a late stage. The Group considers that this uncertainty means that the criteria for capitalisation are not met unless it is highly probable that regulatory approval will be achieved and the project is commercially viable.

Where development costs are capitalised, the expenditure includes the cost of materials, direct labour and an appropriate proportion of overheads.

Capitalised development expenditure is stated at cost less accumulated amortisation and impairment losses.

### (iii) Acquired Intangible Assets

Intangible assets recognised as a result of a business combination are stated at fair value at the date of acquisition less accumulated amortisation and impairment losses.

### (iv) Other Intangible Assets

Other intangible assets that are acquired by the Group are stated at cost less accumulated amortisation and impairment losses. Expenditure on internally generated goodwill and other intangibles is recognised in the income statement as an expense is incurred.

### (v) Subsequent Expenditure

Subsequent expenditure on capitalised intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

### (vi) Amortisation

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets unless such lives are indefinite. Goodwill and intangible assets with an indefinite useful life are systematically tested for impairment at each balance sheet date. Other intangible assets are amortised from the date that they are available for use. The estimated useful lives are as follows:

| | |
|---|---|
| software | 5 years |
| capitalised development costs | 5–10 years |
| customer relationships | 10 years |
| patent rights | Period of patent |
| marketing authorisations | Indefinite life |
| product rights | Period of product rights |

### (i) Trade and Other Receivables

Trade and other receivables are stated at their amortised cost as reduced by appropriate allowances for estimated irrecoverable amounts as described in Section l below.

### (j) Inventories

Inventories are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

The cost of inventories is based on the first-in, first-out principle and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes an appropriate share of overheads based on normal operating capacity.

### (k) Cash and Cash Equivalents

Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

### (l) Impairment

The carrying amounts of the Group's assets, other than inventories and deferred tax assets, are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated.

The recoverable amount of assets is the greater of their net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

For goodwill, assets that have an indefinite useful life and intangible assets that are not yet available for use, the recoverable amount is estimated at each balance sheet date and when there is an indication that the asset is impaired.

An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement.

# Notes to the Consolidated Financial Statements continued

## 1. Accounting Policies continued

Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating units (group of units), and then to reduce the carrying amount of the other assets in the units (group of units) on a pro rata basis.

An impairment loss in respect of goodwill is not reversed.

In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount.

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

### (m) Dividends

Dividends are recognised in the period in which they are approved by the Company's shareholders or, in the case of an interim dividend, when the dividend is paid.

### (n) Interest-Bearing Borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

### (o) Employee Benefits

#### (i) Pensions

The Company operates a Group stakeholder personal pension scheme for certain employees. Obligations for contributions are recognised as an expense in the income statement as incurred.

#### (ii) Share-Based Payment Transactions

The Group operates a number of equity-settled share-based payment programmes that allow employees to acquire shares of the Company. The Group also operates a Long Term Incentive Plan for Directors and senior executives.

The fair value of shares or options granted is recognised as an employee expense on a straight-line basis in the income statement with a corresponding movement in equity. The fair value is measured at grant date and spread over the period during which the employees become unconditionally entitled to the shares or options (the vesting period). The fair value of the shares or options granted is measured using a valuation model taking into account the terms and conditions upon which the shares or options were granted. The amount recognised as an expense in the income statement is adjusted to take into account an estimate of the number of shares or options that are expected to vest together with an adjustment to reflect the number of shares or options that actually do vest except where forfeiture is only due to market-based conditions not being achieved.

The fair value of grants under the Long Term Incentive Plan has been determined using the Monte Carlo simulation model.

The fair values of options granted under all other share option schemes have been determined using the Black-Scholes option pricing model.

### (p) Trade and Other Payables

Trade and other payables are stated at their amortised cost.

### (q) Revenue

#### (i) Goods Sold

For both Pharmaceuticals and Services, revenue from the sale of goods is recognised in the income statement when the significant risks and rewards of ownership have been transferred to the buyer. This is normally when the buyer takes delivery of the goods. Appropriate provision is made, based on past experience, for the possible return of goods and discounts given to customers.

#### (ii) Milestone Payments

Milestone payments received from the granting of distribution and marketing rights for products are recognised in the income statement over the period in which the Company fulfils all of its obligations relating to such payments.

## 1. Accounting Policies continued

### (r) Expenses

#### (i) Operating Lease Payments

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised in the income statement evenly over the period of the lease, as an integral part of the total lease expense.

#### (ii) Finance Lease Payments

Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability.

#### (iii) Net Financing Costs

Net financing costs comprise interest payable on borrowings, interest receivable on funds invested and gains and losses on hedging instruments that are recognised in the income statement (see accounting policy f).

Interest income is recognised in the income statement as it accrues. The interest expense component of finance lease payments is recognised in the income statement using the effective interest rate method.

### (s) Income Tax

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method and represents the tax payable or recoverable on most temporary differences which arise between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes (the tax base). Temporary differences are not provided on: goodwill that is not deductible for tax purposes; the initial recognition of assets or liabilities that affect neither accounting nor taxable profit and do not arise from a business combination; and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates expected to apply in the period in which the liability is settled or the asset is realised and is based upon tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is not probable that the related tax benefit will be realised against future taxable profits. The carrying amounts of deferred tax assets are reviewed at each balance sheet date.

### (t) Segment Reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

### (u) Operating Profit and Operating Cash Flow

Operating profit and operating cash flow is stated before investment income and finance costs.

## 2. Segmental Analysis

The Group's primary reporting segment is business divisions which correspond with the way the operating businesses are organised and managed within the Group and its secondary segment is geographical origin.

Segment results, assets and liabilities comprise those items directly attributable to particular segments as well as items which can reasonably be allocated to those segments. Inter-segment transactions are entered into applying normal commercial terms that would be available to third parties.

Unallocated items comprise mainly corporate assets, expenses, loans and borrowings together with the elimination of inter-segment transactions.

The composition of the segments is detailed in the Directors' Business Review section of this Annual Report.

The following table analyses revenue and operating profit accordingly:

**Business Segment**

| | Pharmaceuticals | | Services | | Unallocated | | Total | |
|---|---|---|---|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 | **2007** | 2006 | **2007** | 2006 |
| | **£'000** | £'000 | **£'000** | £'000 | **£'000** | £'000 | **£'000** | £'000 |
| **Revenue** | | | | | | | | |
| External customers | **19,736** | 17,001 | **234,067** | 215,470 | **—** | — | **253,803** | 232,471 |
| Inter-segment | **6,912** | 6,251 | **140** | 86 | **(7,052)** | (6,337) | **—** | — |
| Total revenue | **26,648** | 23,252 | **234,207** | 215,556 | **(7,052)** | (6,337) | **253,803** | 232,471 |
| Operating profit | **6,081** | 4,868 | **9,519** | 8,681 | **(1,751)** | (1,237) | **13,849** | 12,312 |
| Finance income | | | | | | | **1,044** | 725 |
| Finance expense | | | | | | | **(2,274)** | (1,993) |
| Profit before taxation | | | | | | | **12,619** | 11,044 |
| Income tax expense | | | | | | | **(3,772)** | (3,487) |
| Profit for the year | | | | | | | **8,847** | 7,557 |
| **Assets** | | | | | | | | |
| Intangible assets | **9,382** | 5,104 | **3,707** | 2,423 | **—** | — | **13,089** | 7,527 |
| Property, plant and equipment | **3,624** | 3,571 | **2,115** | 2,024 | **—** | — | **5,739** | 5,595 |
| Other assets | **15,071** | 11,071 | **70,090** | 64,235 | **156** | 2,181 | **85,317** | 77,487 |
| Cash offset | **—** | — | **—** | — | **(6,190)** | — | **(6,190)** | — |
| Total assets | **28,077** | 19,746 | **75,912** | 68,682 | **(6,034)** | 2,181 | **97,955** | 90,609 |
| **Liabilities** | | | | | | | | |
| Borrowings | **(586)** | (508) | **(1,489)** | (1,056) | **(20,310)** | (17,095) | **(22,385)** | (18,659) |
| Other liabilities | **(5,452)** | (3,026) | **(42,571)** | (41,965) | **(3,229)** | (3,044) | **(51,252)** | (48,035) |
| Cash offset | **—** | — | **—** | — | **6,190** | — | **6,190** | — |
| Total liabilities | **(6,038)** | (3,534) | **(44,060)** | (43,021) | **(17,349)** | (20,139) | **(67,447)** | (66,694) |
| Net assets/(liabilities) | **22,039** | 16,212 | **31,852** | 25,661 | **(23,383)** | (17,958) | **30,508** | 23,915 |
| **Other Segment Items** | | | | | | | | |
| Capital expenditure | | | | | | | | |
| — intangible assets | **4,611** | 552 | **1,348** | 72 | **—** | — | **5,959** | 624 |
| — property, plant and equipment | **549** | 469 | **595** | 1,066 | **—** | — | **1,144** | 1,535 |
| Total capital expenditure | **5,160** | 1,021 | **1,943** | 1,138 | **—** | — | **7,103** | 2,159 |
| Share-based payments charge | **—** | — | **—** | — | **596** | 515 | **596** | 515 |
| Depreciation and amortisation | **569** | 566 | **552** | 456 | **—** | — | **1,121** | 1,022 |

## 2. Segmental Analysis continued

### Geographical Segment

In presenting information on the basis of geographical segments, IAS14 'Segment Reporting' requires segment revenues to be based on the geographical location of customers. In this respect, £247,920,000 arises from customers in the UK (2006: £228,191,000) and £5,883,000 from customers in the rest of the world (2006: £4,280,000). The table below gives additional information in respect of segment revenue and segment operating profit, based on the geographical location of the business unit supplying the goods or services. Segment assets and capital expenditure are based on the geographical location of the assets and expenditure. Activities in the UK comprise all operating segments. Overseas operations comprise pharmaceuticals only.

| | UK | | USA | | Unallocated | | Total | |
|---|---|---|---|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 | **2007** | 2006 | **2007** | 2006 |
| | **£'000** | £'000 | **£'000** | £'000 | **£'000** | £'000 | **£'000** | £'000 |
| Revenue by geographical origin | **253,429** | 232,145 | **374** | 326 | **—** | — | **253,803** | 232,471 |
| Operating profit by geographical origin | **15,798** | 13,809 | **(198)** | (260) | **(1,751)** | (1,237) | **13,849** | 12,312 |
| Total assets | **102,533** | 88,190 | **1,456** | 238 | **(6,034)** | 2,181 | **97,955** | 90,609 |
| Capital expenditure | | | | | | | | |
| — intangible assets | **5,959** | 624 | **—** | — | **—** | — | **5,959** | 624 |
| — property, plant and equipment | **1,141** | 1,532 | **3** | 3 | **—** | — | **1,144** | 1,535 |
| Total capital expenditure | **7,100** | 2,156 | **3** | 3 | **—** | — | **7,103** | 2,159 |

## 3. Finance Income

| | **2007** | 2006 |
|---|---|---|
| | **£'000** | £'000 |
| Bank interest receivable | **1,018** | 627 |
| Other interest receivable | **26** | 52 |
| Fair value gains on derivative financial instruments | **—** | 46 |
| Total finance income | **1,044** | 725 |

## 4. Finance Expense

| | **2007** | 2006 |
|---|---|---|
| | **£'000** | £'000 |
| Bank loans and overdrafts | **2,042** | 1,913 |
| Finance charges payable on finance leases and hire purchase contracts | **186** | 64 |
| Fair value losses on derivative financial instruments | **46** | 16 |
| Total finance expense | **2,274** | 1,993 |

## 5. Profit before Taxation

The following items have been included in arriving at profit before taxation:

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Cost of inventories recognised as an expense | 214,602 | 197,127 |
| Impairment of inventories included in above figure | 446 | 83 |
| Depreciation of property, plant and equipment | | |
| — owned assets | 806 | 802 |
| — under finance leases | 178 | 84 |
| Amortisation of intangible assets | 137 | 136 |
| (Profit) on disposal of property, plant and equipment | (7) | (23) |
| Impairment of receivables | 1,183 | 455 |
| Operating lease rentals payable | 2,124 | 2,042 |
| Research and development expenditure as incurred | 1,645 | 1,378 |
| Auditors' remuneration | 275 | 236 |
| Analysis of total fees paid to the auditors: | | |
| Audit of these financial statements | 25 | 24 |
| Audit of financial statements of subsidiaries pursuant to legislation | 78 | 75 |
| Other services pursuant to legislation | 8 | 28 |
| Other services relating to taxation | 149 | 109 |
| Services relating to corporate finance transactions entered into or proposed to be entered into by or on behalf of the Company or the Group | 15 | — |
| | 275 | 236 |

## 6. Employees

The average numbers of staff employed by the Group during the year, which includes Directors, were:

| | 2007 Number | 2006 Number |
|---|---|---|
| Manufacturing | 147 | 132 |
| Distribution | 390 | 364 |
| Administration | 210 | 195 |
| | 747 | 691 |

The costs incurred in respect of these employees were:

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Wages and salaries | 13,992 | 12,895 |
| Social security costs | 1,359 | 1,171 |
| Other pension costs | 403 | 338 |
| Share-based payments charge (see note 22) | 596 | 515 |
| | 16,350 | 14,919 |

Related party transactions — the remuneration of key management was as follows:

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Wages and salaries (including benefits in kind) | 1,499 | 1,176 |
| Social security costs | 192 | 151 |
| Other pension costs | 111 | 85 |
| Share-based payments charge | 296 | 384 |
| | 2,098 | 1,796 |

Key management comprises Executive Directors, the Product Development and Regulatory Affairs Director and the Divisional Managing Directors.

Details of the remuneration, shareholdings, share options and pension contributions of the Executive Directors are included in the Directors' Remuneration Report on pages 30 to 33.

The Group operates a stakeholder personal pension scheme for certain employees. The Group contributed between 4% and 13% of pensionable salaries which amounted to £403,000 (2006: £338,000).

## 7. Income Tax Expense

| | | 2007 £'000 | 2006 £'000 |
|---|---|---|---|
| Current tax | — charge for current year | 3,361 | 3,491 |
| | — adjustment in respect of prior years | (69) | (58) |
| Total current tax expense | | 3,292 | 3,433 |
| Deferred tax | — origination and reversal of temporary differences | 409 | 4 |
| | — adjustment in respect of prior years | 71 | 50 |
| Total deferred tax expense | | 480 | 54 |
| Total income tax expense in the income statement | | 3,772 | 3,487 |

All taxation is in the United Kingdom.

The tax on the Group's profit before tax differs from the standard rate of UK corporation tax of 30% (2006: 30%). The differences are explained below:

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Profit before taxation | 12,619 | 11,044 |
| Tax at 30% | 3,786 | 3,313 |
| Effect of: | | |
| — depreciation on assets not eligible for tax allowances | 47 | 27 |
| — disallowable expenses | 41 | 33 |
| — overseas trading losses | 58 | 78 |
| — (over)/under-recovery of deferred tax on share-based payments | (46) | 44 |
| — research and development tax credits | (60) | — |
| — reduction in tax rate used to calculate deferred tax liability | (56) | — |
| — adjustments in respect of prior years | 2 | (8) |
| Total income tax expense | 3,772 | 3,487 |

Additional current tax credits of £454,000 (2006: £367,000) and deferred tax credits of £1,000 (2006: £62,000) have been recognised directly in equity.

## 8. Dividends

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Final dividend paid in respect of prior year but not recognised as a liability in | | |
| that year 4.33p per share (2006: 3.50p) | 2,278 | 1,794 |
| Interim dividend paid 2.50p per share (2006: 1.91p) | 1,317 | 983 |
| Total dividend 6.83p per share (2006: 5.41p) recognised as distributions to | | |
| equity holders in the period | 3,595 | 2,777 |
| Proposed final dividend for the year ended 30 June 2007 5.00p per share (2006: 4.33p) | 2,640 | 2,248 |
| Total dividend paid and proposed for the year ended 30 June 2007 7.50p | | |
| per share (2006: 6.24p) | 3,957 | 3,231 |

In accordance with IAS10 'Events After the Balance Sheet Date', the proposed final dividend for the year ended 30 June 2007 has not been accrued for in these financial statements. It will be shown as a deduction from equity in the financial statements for the year ending 30 June 2008.

The proposed final dividend for the year ended 30 June 2006 is shown as a deduction from equity in the year ended 30 June 2007.

## 9. Earnings per Share

Earnings per ordinary share have been calculated by dividing the profit attributable to equity holders of the parent after taxation for each financial period by the weighted average number of ordinary shares in issue during the period.

| | 2007 Pence | 2006 Pence |
|---|---|---|
| Basic earnings per share | **16.86** | 14.71 |
| Diluted earnings per share | **16.62** | 14.36 |
| The calculation of basic and diluted earnings per share is based upon: | | |
| | **£'000** | £'000 |
| Earnings for basic and diluted earnings per share calculations | **8,847** | 7,557 |
| | **No.** | No. |
| Weighted average number of ordinary shares for basic earnings per share | **52,482,659** | 51,385,648 |
| Impact of share options | **737,011** | 1,227,342 |
| Weighted average number of ordinary shares for diluted earnings per share | **53,219,670** | 52,612,990 |

## 10. Intangible Assets

| **Cost** | Goodwill £'000 | Software £'000 | Development costs £'000 | Patent rights £'000 | Product rights £'000 | Marketing authorisations £'000 | Acquired intangibles £'000 | Total £'000 |
|---|---|---|---|---|---|---|---|---|
| At 1 July 2005 | 4,385 | 288 | 631 | 789 | 278 | 822 | — | 7,193 |
| Additions | — | 429 | 195 | — | — | — | — | 624 |
| At 30 June 2006 and 1 July 2006 | 4,385 | 717 | 826 | 789 | 278 | 822 | — | 7,817 |
| Additions | 467 | 591 | 1,680 | 257 | 2,556 | 31 | 377 | 5,959 |
| Disposals | — | — | — | — | (278) | — | — | (278) |
| **At 30 June 2007** | **4,852** | **1,308** | **2,506** | **1,046** | **2,556** | **853** | **377** | **13,498** |
| **Amortisation** | | | | | | | | |
| At 1 July 2005 | — | 33 | 121 | — | — | — | — | 154 |
| Charge for the year | — | 58 | 60 | — | 18 | — | — | 136 |
| At 30 June 2006 and 1 July 2006 | — | 91 | 181 | — | 18 | — | — | 290 |
| Charge for the year | — | 58 | 52 | — | 21 | — | 6 | 137 |
| Disposals | — | — | — | — | (18) | — | — | (18) |
| **At 30 June 2007** | **—** | **149** | **233** | **—** | **21** | **—** | **6** | **409** |
| **Net book value** | | | | | | | | |
| **At 30 June 2007** | **4,852** | **1,159** | **2,273** | **1,046** | **2,535** | **853** | **371** | **13,089** |
| At 30 June 2006 and 1 July 2006 | 4,385 | 626 | 645 | 789 | 260 | 822 | — | 7,527 |
| At 1 July 2005 | 4,385 | 255 | 510 | 789 | 278 | 822 | — | 7,039 |

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Contracted capital commitments | **200** | 563 |
| Software assets in the course of construction included above | **1,158** | 626 |

Goodwill is allocated across cash generating units and consequently a consistent approach in assessing the carrying value of this amount is taken. Key assumptions made in this respect are given in note 12. The addition in the year arose from the acquisition of Leeds Veterinary Laboratories Limited (see note 25).

Development costs are internally generated. All other additions to intangible assets were acquired outside the Group and have been measured at cost or fair value at the time of acquisition.

The amortisation charge is recognised within administrative expenses in the income statement.

During the year ended 30 June 2003, the Group entered into an agreement with Bioenvision, a company based in the USA, to acquire the exclusive marketing and development rights of Trilostane for animal health applications in the USA and Canada. Trilostane is the active ingredient in the Group's branded product *Vetoryl* Capsules. The first stage payment of £789,000 including legal costs was made in 2003 and has been capitalised as a patent right. Depending upon certain milestones being achieved, the Group is committed to making two further payments. The second stage payment of US$750,000 becomes payable on the submission of a New Animal Drug Application to the US Food and Drug Administration ("FDA") and the final payment of US$3,000,000 becomes payable on the FDA granting a marketing authorisation for *Vetoryl* Capsules. Once a marketing authorisation has been granted and the patent right can be applied commercially, the patent rights will begin to be amortised.

On 14 May 2007 the Group entered into an exclusive trademark and licensing agreement to market and distribute the Pharmaderm range of products for consideration of $5.0 million (£2.556 million). The payment is being amortised on a straight-line basis over the 15 year life of the agreement.

## 10. Intangible Assets continued

£822,000 of the marketing authorisations relate to the *Vetivex* range of products. The *Vetivex* marketing authorisations are regarded as having indefinite useful economic lives and have not been amortised. Ownership of the marketing authorisations rests with the Group in perpetuity. There are not believed to be any legal, regulatory or contractual provisions that limit their useful lives. *Vetivex* is an established range of products which are relatively simple in nature and there are a limited number of players in the market. Accordingly, the Directors believe that it is appropriate that the marketing authorisations are treated as having indefinite lives for accounting purposes.

Acquired intangibles are customer relationships which were recognised on the acquisition of Leeds Veterinary Laboratories Limited (see note 25).

## 11. Property, Plant and Equipment

| | Freehold land £'000 | Short leasehold buildings £'000 | Motor vehicles £'000 | Plant and fixtures £'000 | Total £'000 |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| At 1 July 2005 | 13 | 2,444 | 538 | 6,307 | 9,302 |
| Additions | — | 157 | — | 1,378 | 1,535 |
| Disposals | — | — | (105) | (185) | (290) |
| At 30 June 2006 and 1 July 2006 | 13 | 2,601 | 433 | 7,500 | 10,547 |
| Additions | — | 27 | — | 1,079 | 1,106 |
| Acquisition through business combinations | — | — | — | 38 | 38 |
| Disposals | — | — | — | (33) | (33) |
| **At 30 June 2007** | **13** | **2,628** | **433** | **8,584** | **11,658** |
| **Depreciation** | | | | | |
| At 1 July 2005 | — | 415 | 537 | 3,404 | 4,356 |
| Charge for the year | — | 135 | 1 | 750 | 886 |
| Disposals | — | — | (105) | (185) | (290) |
| At 30 June 2006 and 1 July 2006 | — | 550 | 433 | 3,969 | 4,952 |
| Charge for the year | — | 147 | — | 837 | 984 |
| Disposals | — | — | — | (17) | (17) |
| **At 30 June 2007** | **—** | **697** | **433** | **4,789** | **5,919** |
| **Net book value** | | | | | |
| **At 30 June 2007** | **13** | **1,931** | **—** | **3,795** | **5,739** |
| At 30 June 2006 and 1 July 2006 | 13 | 2,051 | — | 3,531 | 5,595 |
| At 1 July 2005 | 13 | 2,029 | 1 | 2,903 | 4,946 |
| **Net book value of assets held under finance leases** | | | | | |
| **At 30 June 2007** | **—** | **70** | **—** | **1,172** | **1,242** |
| At 30 June 2006 and 1 July 2006 | — | 77 | — | 1,028 | 1,105 |
| At 1 July 2005 | — | — | — | 224 | 224 |

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Assets in the course of construction included above | **370** | 818 |
| Contracted capital commitments | **61** | 260 |

## 12. Impairment Reviews

Goodwill, indefinite life assets and intangible assets not yet available for use are tested for impairment annually, or more frequently if there are indications that amounts might be impaired. The impairment test involves determining the recoverable amounts of the relevant cash-generating unit, which corresponds to the higher of the fair value less costs to sell or its value in use. Value in use calculations have been performed using the methods and assumptions detailed below:

### (a) Goodwill

The carrying amount of goodwill shown in note 10 comprises £2,621,000 (2006: £2,154,000) relating to the acquisition of North Western Laboratories Limited and Leeds Veterinary Laboratories Limited and £2,231,000 (2006: £2,231,000) relating to the acquisition of Anglian Pharma plc. For the purpose of annual impairment reviews the goodwill relating to North Western Laboratories and Leeds Veterinary Laboratories Limited has been allocated to the Laboratories cash-generating unit whilst the goodwill relating to Anglian Pharma plc has been allocated to the Dales Pharmaceuticals cash-generating unit. The recoverable amount of both units is based on value in use calculations. The value in use of each of these cash-generating units has been determined by discounting projected future cash flows by a pre-tax discount rate of 14.6%, being the Directors' estimate of the weighted average cost of capital of the Company.

Projected future cash flows have been derived from the annual budget for the year ending 30 June 2008 extrapolated over a 10 year period applying a growth rate of 5% per annum up to year five. No growth in revenues is assumed beyond year five.

In both cases, the value in use is significantly higher than the carrying amount and no impairment provision is therefore required.

### (b) Indefinite Life Assets

The Directors consider that the *Vetivex* marketing authorisations with a carrying amount of £822,000 have an indefinite life. Their value in use has been determined by discounting projected future cash flows by a pre-tax discount rate of 14.6%, being the Directors' estimate of the weighted average cost of capital of the Company. Projected future cash flows have been derived from the annual budget for the year ending 30 June 2008 extrapolated over a 10 year period applying a growth rate of 5% per annum up to year five. No growth in revenues is assumed beyond year five.

The value in use is significantly higher than the carrying amount and no impairment provision is therefore required.

### (c) Intangible Assets not yet available for use

#### (i) *Vetoryl*

The Group is developing an intangible asset in respect of authorisation to market our product *Vetoryl* Capsules in the USA. This intangible asset will only be available for use once marketing authorisation is received from the FDA.

The carrying amount in respect of this intangible asset is as follows:

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Payment to acquire patent rights to Trilostane (the active ingredient of *Vetoryl* Capsules) | 789 | 789 |
| Subsequent development costs | 1,263 | 323 |
| | 2,052 | 1,112 |

Value in use has been determined by discounting the projected cash flows by a pre-tax discount rate of 19.6%. The higher discount rate reflects the uncertainty of the timing of future cash flows. Projected cash flows have been determined from a detailed marketing plan covering a five year period from product launch extrapolated up to 30 June 2017. No growth in revenues is assumed after the fifth year following launch. The marketing plan uses data on the market size and market penetration taking into account our experience in launching *Vetoryl* Capsules in other territories.

Based upon the above calculation, the value in use is significantly higher than the carrying amount and no impairment provision is required.

#### (ii) *Felimazole*

The Group is developing an intangible asset in respect of authorisation to market our product *Felimazole* Tablets in the USA. This intangible asset will only be available for use once market authorisation is received from the FDA. At 30 June 2007, the carrying value of this intangible asset (included within development costs) was £344,000 (2006: £nil).

Value in use has been determined by discounting the projected cash flows by a pre-tax discount rate of 19.6%. The higher discount rate reflects the uncertainty of the timing of future cash flows. Projected cash flows have been determined from a detailed marketing plan covering a five year period from product launch extrapolated up to 30 June 2017. No growth in revenues is assumed after the fifth year following launch. The marketing plan uses data on the market size and market penetration taking into account our experience in launching *Felimazole* Tablets in other territories.

Based upon the above calculation, the value in use is significantly higher than the carrying amount and no impairment provision is required.

## 13. Deferred Taxes

### (a) Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

| | Assets | | Liabilities | | Net | |
|---|---|---|---|---|---|---|
| | **2007 £'000** | 2006 £'000 | **2007 £'000** | 2006 £'000 | **2007 £'000** | 2006 £'000 |
| Intangible assets | **—** | — | **(740)** | (193) | **(740)** | (193) |
| Property, plant and equipment | **—** | — | **(325)** | (311) | **(325)** | (311) |
| Inventories | **—** | — | **—** | — | **—** | — |
| Receivables | **30** | 98 | **—** | — | **30** | 98 |
| Cash and cash equivalents | **—** | — | **—** | — | **—** | — |
| Borrowings | **—** | — | **—** | — | **—** | — |
| Payables | **32** | 38 | **—** | — | **32** | 38 |
| Current tax liabilities | **—** | — | **—** | — | **—** | — |
| Share-based payments | **856** | 813 | **—** | — | **856** | 813 |
| | **918** | 949 | **(1,065)** | (504) | **(147)** | 445 |

On the basis that all deferred income taxes relate to the UK and that there is a legally enforceable right to offset current tax liabilities against current tax assets, deferred income tax assets and liabilities have been offset.

The reduction in the UK tax rate from 30% to 28% announced in Spring 2007 was "substantively enacted" when the Bill for the 2007 Finance Act passed through the House of Commons on 26 June 2007. The 28% rate has been used to calculate the tax effect of deferred tax timing differences.

### (b) Unrecognised deferred tax assets

| | **2007 £'000** | 2006 £'000 |
|---|---|---|
| Tax losses | **166** | 108 |

No deferred tax asset has been recognised in respect of the losses incurred by the Company's USA subsidiary due to the uncertainty of achieving taxable profits in the USA against which the losses can be offset.

### (c) Movement in temporary differences during the year

| | Balance at 1 July 2005 £'000 | Adoption of IAS39 £'000 | Recognised in income £'000 | Recognised in equity £'000 | Balance at 30 June 2006 £'000 |
|---|---|---|---|---|---|
| Intangible assets | (153) | — | (40) | — | (193) |
| Property, plant and equipment | (272) | — | (39) | — | (311) |
| Inventories | — | — | — | — | — |
| Receivables | 45 | 17 | 36 | — | 98 |
| Cash and cash equivalents | — | — | — | — | — |
| Borrowings | — | — | — | — | — |
| Payables | 103 | 14 | (79) | — | 38 |
| Current tax liabilities | — | — | — | — | — |
| Share-based payments | 683 | — | 68 | 62 | 813 |
| | 406 | 31 | (54) | 62 | 445 |

| | Balance at 1 July 2006 £'000 | Acquisitions £'000 | Recognised in income £'000 | Recognised in equity £'000 | **Balance at 30 June 2007 £'000** |
|---|---|---|---|---|---|
| Intangible assets | (193) | (113) | (434) | — | **(740)** |
| Property, plant and equipment | (311) | — | (14) | — | **(325)** |
| Inventories | — | — | — | — | **—** |
| Receivables | 98 | — | (68) | — | **30** |
| Cash and cash equivalents | — | — | — | — | **—** |
| Borrowings | — | — | — | — | **—** |
| Payables | 38 | — | (6) | — | **32** |
| Current tax liabilities | — | — | — | — | **—** |
| Share-based payments | 813 | — | 42 | 1 | **856** |
| | 445 | (113) | (480) | 1 | **(147)** |

## 14. Inventories

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Raw materials and consumables | 2,250 | 1,443 |
| Work in progress | 208 | 117 |
| Finished goods and goods for resale | 23,274 | 20,397 |
| | 25,732 | 21,957 |

## 15. Trade and Other Receivables

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Trade receivables | 34,029 | 33,476 |
| Other receivables | 1,368 | 1,073 |
| Prepayments and accrued income | 776 | 798 |
| | 36,173 | 35,347 |

Trade receivables are stated after an impairment provision of £3,171,000 (2006: £2,035,000).

## 16. Cash and Cash Equivalents

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Cash at bank and in hand | 1,468 | 4,552 |
| Short-term deposits | 15,754 | 15,186 |
| | 17,222 | 19,738 |

The short-term deposits are repayable on demand.

## 17. Trade and Other Payables

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Trade payables | 44,019 | 41,988 |
| Other payables | 605 | 491 |
| Other taxation and social security | 1,978 | 1,373 |
| Accruals and deferred income | 2,039 | 1,678 |
| | 48,641 | 45,530 |

## 18. Current Tax Liabilities

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Corporation tax payable | 2,464 | 2,505 |

## 19. Borrowings

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Current liabilities | | |
| Bank loans and overdrafts | 4,000 | 3,019 |
| Finance lease obligations | 529 | 398 |
| | 4,529 | 3,417 |
| Non-current liabilities | | |
| Bank loans | 10,200 | 14,200 |
| Finance lease obligations | 1,546 | 1,147 |
| Arrangement fees netted off | (80) | (105) |
| | 11,666 | 15,242 |
| Total borrowings | 16,195 | 18,659 |

At the year end, the Group had the following unutilised borrowing facilities:

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Revolving credit facility | 5,000 | 5,000 |
| Bank overdraft facility | 4,000 | 4,000 |
| | 9,000 | 9,000 |

The term loan from Bank of Scotland is secured by a fixed and floating charge on the assets of the Group. Interest is charged at 1.25% over LIBOR. The loan is repayable in instalments up to 30 June 2010.

The overdraft facility is renewable annually whilst the revolving credit facility is committed until 30 June 2010.

The maturity of the bank loans and overdrafts is as follows:

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Payable: | | |
| Within one year | 4,000 | 3,019 |
| Between one and two years | 5,000 | 4,000 |
| Between two and five years | 5,200 | 10,200 |
| | 14,200 | 17,219 |

The minimum lease payments and the present value of minimum lease payments payable under finance lease obligations are:

| | Minimum Lease Payments | | Present Value of Minimum Lease Payments | |
|---|---|---|---|---|
| | 2007 £'000 | 2006 £'000 | 2007 £'000 | 2006 £'000 |
| Within one year | 704 | 503 | 529 | 398 |
| Between one and two years | 623 | 444 | 511 | 375 |
| Between two and five years | 1,153 | 835 | 1,035 | 772 |
| Total minimum lease payments | 2,480 | 1,782 | 2,075 | 1,545 |
| Future finance charges | (405) | (237) | — | — |
| Present value of lease obligations | 2,075 | 1,545 | 2,075 | 1,545 |

Further information on the interest profile of borrowings is shown in note 20.

## 20. Financial Instruments

The Group's financial instruments comprise cash deposits, bank loans and overdrafts, finance lease obligations, derivatives used for hedging purposes and trade receivables and payables.

### Treasury Policy

Treasury policy is set by the Board and monitored by the Group Finance Director. The Group does not speculate on short-term interest or exchange rate movements. Derivatives are used only to hedge underlying commercial positions and are not used for speculative or trading purposes.

### Financial Risk Management

#### (i) Interest rate risk

All cash deposits and bank loans and overdrafts bear interest at floating rates linked to base rate or LIBOR and are consequently exposed to cash flow interest rate risk.

The Group seeks to hedge interest rate risk on between 20% and 80% of outstanding bank loans. By way of a separate derivative financial instrument, £4,733,000 of outstanding loans are subject to a floor and ceiling arrangement whereby the Group's exposure to fluctuations in LIBOR is limited to a minimum rate of 4.53% and a maximum rate of 5.50%. All finance leases and hire purchase contracts are at fixed rates determined at the inception of the contract.

Sensitivity — a 1% increase in interest rates would reduce Group profit before taxation by £119,000.

#### (ii) Foreign exchange risk

Foreign exchange exposure is hedged naturally as far as possible by matching receipts and payments in the relevant foreign currency. The Group maintains Euro and US Dollar bank accounts for this purpose. Unmatched foreign currency exposure is hedged at the discretion of the Group Finance Director within the parameters set by the Board. Hedging instruments allowed to be used are forward contracts and options to purchase the relevant foreign currency.

No borrowings are denominated in foreign currencies.

#### (iii) Credit risk

Cash is only deposited with highly rated UK-based banks.

The Group offers trade credit to customers in the normal course of business. Trade and bank references are obtained prior to extending credit.

Insurance is held in respect of overseas receivables.

#### (iv) Concentration of credit risk

The Group sells to a large number of customers and, with the exception of corporate veterinary practices and veterinary wholesalers, credit risk is not highly concentrated. The largest customer accounted for approximately 7.2% of gross trade receivables at 30 June 2007.

#### (v) Liquidity risk

Liquidity risk is the risk that the Group will not have sufficient funds to meet liabilities. Cash forecasts identifying the liquidity requirements of the Group are produced quarterly. These are reviewed to ensure sufficient financial headroom exists for at least a 12 month period.

The Group's undrawn borrowing facilities at 30 June 2007 are detailed in note 19.

### Maturity of Financial Instruments

The maturity of financial instruments excluding short-term receivables and payables are shown in notes 16 and 19.

### Interest Rate Profile

The following table shows the effective interest rate at the balance sheet date of interest-bearing financial assets and liabilities and the period in which they reprice or mature.

## 20. Financial Instruments continued

| 2007 | Carrying Value £'000 | Effective Interest Rate % | Period to re-pricing or maturity within: 3 months £'000 | 3 months–1 year £'000 | 1–2 years £'000 | 2–3 years £'000 | 3–4 years £'000 | 4–5 years £'000 |
|---|---|---|---|---|---|---|---|---|
| Financial assets | | | | | | | | |
| — bank deposits (a) | 15,754 | 5.3 | 15,754 | — | — | — | — | — |
| Financial liabilities | | | | | | | | |
| — bank loans (b) | (14,120) | 7.3 | (14,120) | — | — | — | — | — |
| — finance leases (c) | (2,075) | 7.9 | — | (14) | — | (594) | (183) | (1,284) |
| | (16,195) | | | | | | | |

(a) Floating rate at 0.5% below base rate.
(b) Floating rate at 1.25% above LIBOR.
(c) Various fixed interest rates with a weighted average rate of 7.9%.

| 2006 | Carrying Value £'000 | Effective Interest Rate % | Period to re-pricing or maturity within: 3 months £'000 | 1–2 years £'000 | 2–3 years £'000 | 3–4 years £'000 | 4–5 years £'000 |
|---|---|---|---|---|---|---|---|
| Financial assets | | | | | | | |
| — bank deposits (a) | 15,186 | 4.0 | 15,186 | — | — | — | — |
| Financial liabilities | | | | | | | |
| — bank loans (b) | (17,114) | 6.0 | (17,114) | — | — | — | — |
| — finance leases (c) | (1,545) | 7.3 | — | (62) | (3) | (787) | (693) |
| | (18,659) | | | | | | |

(a) Floating rate at 0.5% below base rate.
(b) Floating rate at 1.25% above LIBOR.
(c) Various fixed interest rates with a weighted average rate of 7.3%.

### Foreign Currency Profile

At 30 June 2007, the Group had no material financial assets or liabilities denominated in foreign currencies.

### Derivatives

The Group held the following derivatives at 30 June 2007:

| | 2007 Carrying Value £'000 | 2007 Gross notional amount | 2006 Carrying Value £'000 | 2006 Gross notional amount |
|---|---|---|---|---|
| Interest rate floor and ceiling | 14 | £4,733,000 | 2 | £5,733,000 |
| Foreign currency options | 11 | $4,250,000 | — | — |
| | 25 | | 2 | |

Although used for the purpose of hedging interest rate and foreign exchange risk, these derivatives have been designated as held for trading financial instruments for the purposes of IAS39, with changes in fair value being taken through the income statement. The interest rate floor and ceiling matures on 31 December 2007 while the foreign currency options mature on 31 December 2008. All loans held by the Group are measured at amortised cost.

## 20. Financial Instruments continued

### Fair Values of Financial Instruments

The following table summarises the carrying values and fair values of financial assets and liabilities.

| | 2007 | | 2006 | |
|---|---|---|---|---|
| | Carrying Value £'000 | Fair Value £'000 | Carrying Value £'000 | Fair Value £'000 |
| Financial assets | | | | |
| Cash and cash equivalents (a) | **17,222** | **17,222** | 19,738 | 19,738 |
| Trade receivables (a) | **34,029** | **34,029** | 33,476 | 33,476 |
| Derivatives (c) | **25** | **25** | 2 | 2 |
| | **51,276** | **51,276** | 53,216 | 53,216 |
| Financial liabilities | | | | |
| Bank loans (a) | **(14,120)** | **(14,120)** | (17,114) | (17,114) |
| Finance leases (b) | **(2,075)** | **(2,168)** | (1,545) | (1,583) |
| Trade payables (a) | **(44,019)** | **(44,019)** | (41,988) | (41,988) |
| Derivatives (c) | **—** | **—** | — | — |
| | **(60,214)** | **(60,307)** | (60,647) | (60,685) |

(a) Due to the nature and/or short-term maturity of these financial instruments, carrying values approximate to fair values.

(b) The fair values of these financial instruments are based upon discounted cash flows, using discount rates based upon the Group's cost of borrowing at the balance sheet date.

(c) The fair values of these financial instruments are based upon the amount that the Group would receive or pay to terminate the instrument at the balance sheet date, being the market price of the instrument.

## 21. Share Capital

| | Ordinary shares of 1p each | | | |
|---|---|---|---|---|
| | 2007 | | 2006 | |
| | £'000 | No. | £'000 | No. |
| Authorised | **750** | **75,000,000** | 750 | 75,000,000 |
| Issued at start of year | **519** | **51,915,002** | 511 | 51,120,964 |
| New shares issued | **9** | **888,697** | 8 | 794,038 |
| At end of year | **528** | **52,803,699** | 519 | 51,915,002 |

During the year, 873,889 new ordinary shares of 1p (2006: 794,038 new ordinary shares of 1p) were issued following the exercise of options under the Executive Incentive Plan and the Approved, Unapproved and SAYE Share Options Schemes. The consideration received was £357,000 (2006: £748,000). In addition, 14,808 new ordinary shares of 1p (2006: nil) were issued in part consideration for the acquisition of Leeds Veterinary Laboratories Limited (see note 25). The market value of these new ordinary shares of 1p at the date of issue was £50,000 and this amount has been credited to merger reserve. The holders of ordinary shares are entitled to receive dividends as declared or approved at General Meetings from time to time and are entitled to one vote per share at meetings of the Company.

## 22. Share-based Payments

During the year, the Company operated the Unapproved Share Option Scheme, the Approved Share Option Scheme, the Executive Incentive Plan and the Save As You Earn ("SAYE") Share Option Scheme as described below:

### Unapproved and Approved Share Option Schemes

Under these Schemes, options are granted to certain executives and employees of the Group (excluding Executive Directors) to purchase shares in the Company at a price fixed at the average market value over the three days prior to the date of grant. For the options to vest, there must be an increase in earnings per share of at least 12% above the growth in the UK Retail Prices Index (RPI) over a three year period. Once vested, options must be exercised within 10 years of the date of grant.

### Executive Incentive Plan

Under this plan Executive Directors and selected senior executives are awarded shares in the Company subject to a Total Shareholder Return ("TSR") target.

The TSR target measures the Company's TSR performance against the FTSE Small Cap Index over a three year measurement period (commencing at the beginning of the financial year in which the awards are made). 100% of the shares vest if the Company achieves an upper quartile performance, 30% of the shares vest at median performance and awards vest on a straight-line basis for performance in between. No shares vest if performance is below median.

In addition, awards will only vest if, in the opinion of the Remuneration Committee, the performance of the Company has been satisfactory.

### SAYE Option Scheme

This Scheme is open to all UK employees. Participants save a fixed amount of up to £250 per month for either three, five or seven years and are then able to use these savings to buy shares in the Company at a price fixed at a 20% discount to the market value at the start of the saving period. The SAYE options must ordinarily be exercised within six months of the completion of the relevant savings period. The exercise of these options is not subject to any performance criteria.

Outstanding awards and the movement during the year are shown below:

**Year ended 30 June 2007**

| | Exercise period | Exercise price per share Pence | At 1 July 2006 Number | Exercised Number | Granted Number | Lapsed Number | At 30 June 2007 Number |
|---|---|---|---|---|---|---|---|
| **Unapproved Share Option Scheme** | | | | | | | |
| 14 September 2000 | 2003–2010 | 120 | 131,000 | (79,500) | — | — | **51,500** |
| 22 April 2002 | 2005–2012 | 153.5 | 87,500 | (49,000) | — | — | **38,500** |
| 11 April 2003 | 2006–2013 | 58.5 | 82,500 | (41,000) | — | (6,000) | **35,500** |
| 19 March 2007 | 2010–2017 | 289 | — | — | 26,139 | — | **26,139** |
| | | | 301,000 | (169,500) | 26,139 | (6,000) | **151,639** |
| **Approved Share Option Scheme** | | | | | | | |
| 2 April 2004 | 2007–2014 | 134.5 | 123,000 | (54,000) | — | (2,000) | **67,000** |
| 3 December 2004 | 2007–2014 | 180 | 30,000 | — | — | — | **30,000** |
| 5 April 2005 | 2008–2015 | 202.5 | 171,000 | — | — | (9,000) | **162,000** |
| 15 March 2006 | 2009–2016 | 252 | 175,000 | — | — | (13,000) | **162,000** |
| 19 March 2007 | 2010–2017 | 289 | — | — | 161,861 | — | **161,861** |
| | | | 499,000 | (54,000) | 161,861 | (24,000) | **582,861** |
| **Executive Incentive Plan** | | | | | | | |
| 5 December 2003 | 2006–2007 | — | 505,000 | (505,000) | — | — | **—** |
| 9 October 2004 | 2007–2008 | — | 182,526 | — | — | — | **182,526** |
| 3 October 2005 | 2008–2009 | — | 205,141 | — | — | — | **205,141** |
| 14 September 2006 | 2009–2010 | — | — | — | 216,128 | — | **216,128** |
| | | | 892,667 | (505,000) | 216,128 | — | **603,795** |
| **SAYE Option Scheme** | | | | | | | |
| 26 April 2001 | 2004–2006 | 158 | 28,188 | (18,578) | — | (9,610) | **—** |
| 9 April 2002 | 2005–2007 | 129 | 12,570 | (11,544) | — | (556) | **470** |
| 3 April 2003 | 2006–2008 | 39 | 496,393 | (115,267) | — | (13,889) | **367,237** |
| 15 October 2004 | 2007–2009 | 124 | 129,127 | — | — | (1,680) | **127,447** |
| 18 October 2005 | 2008–2010 | 204 | 98,330 | — | — | (19,194) | **79,136** |
| 12 October 2006 | 2009–2013 | 195.74 | — | — | 153,545 | (16,412) | **137,133** |
| | | | 764,608 | (145,389) | 153,545 | (61,341) | **711,423** |
| **Total** | | | **2,457,275** | **(873,889)** | **557,673** | **(91,341)** | 2,049,718 |
| Weighted average exercise price | | | 79.9p | 40.8p | 151.3p | 166.3p | **115.0p** |

## 22. Share-based Payments continued

### Year ended 30 June 2006

| | Exercise period | Exercise price per share Pence | At 1 July 2005 Number | Exercised Number | Granted Number | Lapsed Number | At 30 June 2006 Number |
|---|---|---|---|---|---|---|---|
| **Unapproved Share Option Scheme** | | | | | | | |
| 14 September 2000 | 2003–2010 | 120 | 343,000 | (210,000) | — | (2,000) | 131,000 |
| 22 April 2002 | 2005–2012 | 153.5 | 317,000 | (229,500) | — | — | 87,500 |
| 11 April 2003 | 2006–2013 | 58.5 | 99,500 | (17,000) | — | — | 82,500 |
| | | | 759,500 | (456,500) | — | (2,000) | 301,000 |
| **Approved Share Option Scheme** | | | | | | | |
| 2 April 2004 | 2007–2014 | 134.5 | 137,000 | — | — | (14,000) | 123,000 |
| 3 December 2004 | 2007–2014 | 180 | 30,000 | — | — | — | 30,000 |
| 5 April 2005 | 2008–2015 | 202.5 | 179,000 | — | — | (8,000) | 171,000 |
| 15 March 2006 | 2009–2016 | 252 | — | — | 177,000 | (2,000) | 175,000 |
| | | | 346,000 | — | 177,000 | (24,000) | 499,000 |
| **Executive Incentive Plan** | | | | | | | |
| 5 December 2003 | 2006–2007 | — | 505,000 | — | — | — | 505,000 |
| 9 October 2004 | 2007–2008 | — | 210,739 | — | — | (28,213) | 182,526 |
| 3 October 2005 | 2008–2009 | — | — | — | 205,141 | — | 205,141 |
| | | | 715,739 | — | 205,141 | (28,213) | 892,667 |
| **SAYE Option Scheme** | | | | | | | |
| 26 April 2001 | 2004–2006 | 158 | 29,896 | — | — | (1,708) | 28,188 |
| 9 April 2002 | 2005–2007 | 129 | 29,078 | (1,766) | — | (14,742) | 12,570 |
| 3 April 2003 | 2006–2008 | 39 | 873,523 | (335,772) | — | (41,358) | 496,393 |
| 15 October 2004 | 2007–2009 | 124 | 142,619 | — | — | (13,492) | 129,127 |
| 18 October 2005 | 2008–2010 | 204 | — | — | 111,078 | (12,748) | 98,330 |
| | | | 1,075,116 | (337,538) | 111,078 | (84,048) | 764,608 |
| **Total** | | | **2,896,355** | **(794,038)** | **493,219** | **(138,261)** | **2,457,275** |
| Weighted average exercise price | | | 74.6p | 94.2p | 136.3p | 89.0p | 79.9p |

For options exercised during the year, the weighted average market price at the date of exercise was 264p (2006: 241p). The weighted average remaining contractual lives of options outstanding at the balance sheet date was 4 years (2006: 3.5 years).

As allowed by the transitional provisions of IFRS1 and IFRS2, included above are options over shares that have not been recognised in accordance with IFRS2 as the options were granted before 7 November 2002.

The fair values for shares granted under the Unapproved, Approved and SAYE Option Schemes have been calculated using the Black-Scholes Option Pricing Model. The fair values of shares awarded under the Executive Incentive Plan have been calculated using a Monte Carlo Simulation Model which takes into account the market-based performance conditions attaching to those shares:

The assumptions used in calculating fair value are as follows:

**Executive Incentive Plan**

| | | | | |
|---|---|---|---|---|
| Date of grant | 14/9/06 | 3/10/05 | 9/10/04 | 5/12/03 |
| Number of shares awarded | 216,128 | 205,141 | 210,739 | 505,000 |
| Share price at date of grant | 250.75p | 251p | 164p | 123p |
| Exercise price | Nil | Nil | Nil | Nil |
| Expected life | 3 years | 3 years | 3 years | 3 years |
| Risk-free rate | 4.70% | 4.21% | 4.69% | 4.57% |
| Volatility | 36% | 36% | 36% | 36% |
| Dividend yield | 2.49% | 2.07% | 2.95% | 3.27% |
| Fair value per share | 162p | 169p | 105p | 78p |

**Unapproved and Approved Share Option Schemes**

| | | | | | | |
|---|---|---|---|---|---|---|
| Date of grant | 19/3/07 | 15/3/06 | 5/4/05 | 3/12/04 | 2/4/04 | 11/4/03 |
| Number of shares awarded | 188,000 | 177,000 | 181,000 | 30,000 | 147,000 | 124,000 |
| Share price at date of grant | 289p | 252p | 212p | 179.32p | 136p | 59p |
| Exercise price | 289p | 252p | 202.5p | 180p | 134.5p | 58.5p |
| Expected life | 5 years | 5 years | 5 years | 5 years | 5 years | 5 years |
| Risk-free rate | 4.98% | 4.32% | 4.61% | 4.53% | 4.76% | 4.12% |
| Volatility | 36% | 36% | 36% | 36% | 36% | 36% |
| Dividend yield | 2.36% | 2.15% | 2.40% | 2.61% | 3.19% | 7.04% |
| Fair value per share | 92p | 79p | 69p | 54p | 40p | 11p |

## 22. Share-based Payments continued

### Save as You Earn Option Scheme

| | | | | |
|---|---|---|---|---|
| Date of grant | 12/10/06 | 18/10/05 | 15/10/04 | 3/4/03 |
| Number of shares awarded | 153,545 | 111,078 | 144,147 | 1,034,938 |
| Share price at date of grant | 257.25p | 255p | 160p | 54p |
| Exercise price | 195.74p | 204p | 124p | 39p |
| Expected life | | | | |
| — three year scheme | 3.25 years | 3.25 years | 3.25 years | 3.25 years |
| — five year scheme | 5.25 years | 5.25 years | 5.25 years | 5.25 years |
| — seven year scheme | 7.25 years | n/a | n/a | n/a |
| Risk-free rate | | | | |
| — three year scheme | 4.85% | 4.25% | 4.56% | 3.78% |
| — five year scheme | 4.75% | 4.31% | 4.64% | 4.14% |
| — seven year scheme | 4.65% | n/a | n/a | n/a |
| Volatility | 36% | 36% | 36% | 36% |
| Dividend yield | 2.43% | 2.04% | 2.92% | 7.63% |
| Fair value per share | | | | |
| — three year scheme | 94p | 88p | 55p | 14p |
| — five year scheme | 104p | 101p | 61p | 14p |
| — seven year scheme | 110p | n/a | n/a | n/a |

National Insurance contributions are payable by the Company in respect of some of the share-based payments. These contributions are payable on the date of exercise based on the intrinsic value of the share-based payments and are therefore treated as cash-settled awards. The Group had an accrual at 30 June 2007 of £181,000 (2006: £241,000), of which £38,000 (2006: £49,000) related to vested options. The total charge to the Income Statement in respect of share-based payments was:

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Equity-settled share-based transactions | **479** | 427 |
| Cash-settled share-based transactions | **117** | 88 |
| | **596** | 515 |

The above charge to the Income Statement was included within administrative expenses.

## 23. Analysis of Net Cash

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Bank loans and overdraft | **(14,120)** | (17,114) |
| Finance leases and hire purchase contracts | **(2,075)** | (1,545) |
| Cash and cash equivalents | **17,222** | 19,738 |
| Net cash | **1,027** | 1,079 |

## 24. Operating Leases

At the balance sheet date the Group had outstanding commitments for future minimum rentals payable under non-cancellable operating leases as follows:

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Within one year | **1,834** | 1,912 |
| Between one and five years | **4,672** | 4,626 |
| In five years or more | **4,295** | 4,535 |
| | **10,801** | 11,073 |

## 25. Acquisition of Subsidiary

On 26 April 2007 the Company acquired the entire share capital of Leeds Veterinary Laboratories Limited. The assets and liabilities acquired are allocated as follows:

| | | Book value £'000 | Fair value adjustments £'000 | Fair value £'000 |
|---|---|---|---|---|
| | Intangible assets | — | 377 | 377 |
| | Property, plant and equipment (see note 11) | 67 | (29) | 38 |
| | Inventories | 38 | — | 38 |
| | Trade and other receivables | 691 | — | 691 |
| | Cash and cash equivalents | 13 | — | 13 |
| | Borrowings | (55) | — | (55) |
| | Trade and other payables | (140) | — | (140) |
| | Current tax | (16) | — | (16) |
| | Deferred tax | — | (113) | (113) |
| | | 598 | 235 | 833 |
| | Goodwill (see note 10) | | | 467 |
| | Total consideration | | | 1,300 |
| | Satisfied by: | | | |
| | Cash | | | 673 |
| | Issue of ordinary shares | | | 50 |
| | Transfer of freehold property | | | 520 |
| | Expenses of acquisition | | | 57 |
| | Total consideration | | | 1,300 |
| | Less: issue of ordinary shares (see note 21) | | | (50) |
| | transfer of freehold property | | | (520) |
| | cash acquired | | | (13) |
| | Cash flow on acquisition | | | 717 |

Intangible assets recognised on acquisition represent customer relationships.

Goodwill represents the expertise and technical knowledge of the company's staff and the long-term strategic benefit of expanding the geographic coverage of the Group's Laboratories business.

For the 12 month period ended 30 June 2007, Leeds Veterinary Laboratories Limited made a profit of £44,000 (before exceptional income of £237,000), of which £28,000 was recognised in the period following acquisition.

If the acquisition had occurred on 1 July 2006, management estimates that consolidated revenue would have been £254,617,000 and consolidated profit for the period would have been £8,863,000 (before exceptional income of £237,000).

## 26. Critical Accounting Judgements and Key Sources of Estimation Uncertainty

### Critical Judgements in applying the Group's Accounting Policies

In the process of applying the Group's accounting policies as described in note 1, the Directors have made the following judgements that have the most significant effect on the amounts recognised in the Financial Statements.

### Intangible Asset — *Vetoryl* Capsules USA

As described in note 12, the Group is carrying a total amount of £2,052,000 in respect of *Vetoryl* Capsules USA. Recoverability of this amount is dependent upon obtaining FDA approval to market *Vetoryl* Capsules in the USA. Based upon positive discussions with the FDA (evidenced by the product being granted expedited review status) and the obtaining of marketing approval in the European Union, the Directors concluded that the obtaining of marketing authorisation in the USA is highly likely and that the criteria for recognising an intangible asset have been met.

### Intangible Asset — *Felimazole* Tablets USA

As described in note 12, the Group is carrying a total amount of £344,000. Recoverability of this amount is dependent upon obtaining FDA approval to market *Felimazole* Tablets in the USA. Based on positive discussions with the FDA and the obtaining of marketing approval in the European Union, the Directors concluded that the obtaining of marketing authorisation in the USA is highly likely and that the criteria for recognising an intangible asset have been met.

### Key Sources of Estimation Uncertainty

The key sources of estimation uncertainty which may cause a material adjustment to the carrying amount of assets and liabilities are discussed below:

### Impairment of Goodwill and Indefinite Life Intangible Assets

The Group determines whether goodwill and indefinite life assets are impaired at least on an annual basis. This requires an estimation of the value-in-use of the cash-generating units to which they are allocated. Estimating the value-in-use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. Further detail on the assumptions used in determining value-in-use calculations is provided in note 12.

### Impairment of Receivables

The Group has estimated impairment of receivables by assessing recoverability of amounts due on a customer by customer basis. As described in note 20, credit risk is not highly concentrated with the exception of Corporate Veterinary Practices and Veterinary Wholesalers. If the receivables due from one of these large customers proved to be irrecoverable then an additional impairment provision may be required.

# Financial History

| | 2007* | 2006* | 2005* | 2004† | 2003† |
|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 |
| **Income statement** | | | | | |
| Revenue | **253,803** | 232,471 | 210,267 | 186,843 | 179,309 |
| Operating profit | **13,849** | 12,312 | 11,255 | 8,493 | 7,101 |
| Profit before taxation | **12,619** | 11,044 | 9,701 | 7,369 | 5,685 |
| Profit after taxation | **8,847** | 7,557 | 7,027 | 5,081 | 3,833 |
| Earnings per share — basic (pence) | **16.86** | 14.71 | 13.77 | 9.97 | 7.52 |
| — diluted (pence) | **16.62** | 14.36 | 13.54 | 9.83 | 7.50 |
| Dividend per share (pence) | **7.50** | 6.24 | 5.20 | 4.70 | 4.12 |
| Average number of employees | **747** | 691 | 679 | 643 | 615 |
| **Balance sheet** | | | | | |
| Non-current assets | **18,828** | 13,567 | 12,391 | 10,398 | 11,302 |
| Working capital | **13,264** | 11,774 | 12,127 | 11,318 | 12,189 |
| Current tax liabilities | **(2,464)** | (2,505) | (2,057) | (1,275) | (1,032) |
| Deferred tax liabilities | **(147)** | — | — | (174) | — |
| Net cash/(borrowings) | **1,027** | 1,079 | (4,859) | (10,110) | (14,988) |
| Shareholders' funds | **30,508** | 23,915 | 17,602 | 10,157 | 7,471 |
| **Cash flow** | | | | | |
| Cash flow from operating activities | **14,328** | 13,997 | 13,549 | 10,576 | 6,542 |
| Net interest paid | **(1,169)** | (1,218) | (1,667) | (1,012) | (1,384) |
| Tax paid | **(2,895)** | (2,618) | (1,996) | (1,864) | (2,066) |
| Capital expenditure | **(5,325)** | (1,492) | (1,925) | (546) | (1,224) |
| Acquisitions | **(717)** | — | — | — | 32 |
| Equity dividends paid | **(3,595)** | (2,777) | (2,473) | (2,192) | (2,078) |
| Financing | **(3,124)** | (97) | 11,760 | (2,588) | (3,410) |
| Changes in cash in period | **(2,497)** | 5,795 | 17,248 | 2,374 | (3,588) |

* Reported under IFRS

† Reported under UK GAAP

The main differences between the information under UK GAAP and IFRS relate to classification of sale of trading data to suppliers, goodwill amortisation, capitalisation of development expenditure, share-based payments charges, treatment of lease incentives, income tax, deferred tax and dividends. These are fully explained in the Annual Report and Financial Statements for the year ended 30 June 2006.

# Company Financial Statements

## Contents

# Company Balance Sheet

| At 30 June 2007 | Note | 2007 £'000 | 2006 £'000 |
|---|---|---|---|
| **Fixed assets** | | | |
| Investments | iv | **54,658** | 53,408 |
| | | **54,658** | 53,408 |
| **Current assets** | | | |
| Debtors | v | **12,366** | 43,536 |
| Cash at bank and in hand | | **7** | 1,638 |
| | | **12,373** | 45,174 |
| **Creditors:** amounts falling due within one year | vi | **(23,348)** | (52,090) |
| **Net current liabilities** | | **(10,975)** | (6,916) |
| **Total assets less current liabilities** | | **43,683** | 46,492 |
| **Creditors:** amounts falling due after more than one year | vi | **(10,120)** | (14,095) |
| **Net assets** | | **33,563** | 32,397 |
| **Capital and reserves** | | | |
| Called up share capital | x | **528** | 519 |
| Share premium account | xi | **28,041** | 27,693 |
| Hedging reserve | xi | **(71)** | (71) |
| Profit and loss account | xi | **5,065** | 4,256 |
| **Total equity shareholders' funds** | | **33,563** | 32,397 |

The financial statements were approved by the Board of Directors on 4 September 2007 and are signed on its behalf by:

**Ian Page** Director

**Simon Evans** Director

# Reconciliation of Movements in Shareholders' Funds



| For the year ended 30 June 2007 | 2007 £'000 | 2006 £'000 |
|---|---|---|
| At start of period | 32,397 | 30,812 |
| Profit for the financial year | 3,925 | 3,187 |
| Share-based payments charge | 479 | 427 |
| Dividends paid | (3,595) | (2,777) |
| New shares issued | 357 | 748 |
| At end of period | 33,563 | 32,397 |

# Notes to the Financial Statements

## (i) Principal Accounting Policies of the Company

### Accounting Principles

The Company Balance Sheet has been prepared under the historical cost convention except for derivatives which are stated at fair value in accordance with applicable UK accounting standards and the Companies Act 1985.

### Basis of Preparation

No Profit and Loss Account is presented for the Company as permitted by Section 230(4) of the Companies Act 1985. The profit dealt with in the accounts of the Company was £3,925,000 (2006: £3,187,000).

### Investments

Investments held as fixed assets are stated at cost less any impairment losses. Where the consideration for the acquisition of a subsidiary undertaking includes shares in the Company to which the provisions of section 131 of the Companies Act 1985 apply, cost represents the nominal value of the shares issued together with the fair value of any additional consideration given and costs.

### Derivative Financial Instruments

The Company uses derivative financial instruments to manage its exposure to foreign exchange and interest rate risks. In accordance with its treasury policy, the Company does not hold or issue derivative financial instruments for speculative purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

On adoption of FRS25 and FRS26, the comparative financial statements were not restated. On 1 July 2005, the fair values of derivatives used for hedging were included in a hedging reserve. The corresponding adjustments were to decrease trade and other receivables by £58,000, increase trade and other payables by £44,000 and increase the deferred tax asset by £31,000. As the Company has not adopted hedge accounting under FRS26 from 1 July 2005 the hedging reserve is frozen and will only be released to the profit and loss account when the related forecast transactions occur.

Derivative financial instruments are recognised initially at fair value. Subsequent to initial recognition, derivative financial instruments are stated at fair value. The gain or loss on remeasurement to fair value is recognised immediately in the profit and loss account.

The fair value of interest rate swaps, floors and ceilings, is the estimated amount that the Group would receive or pay to terminate the instrument at the balance sheet date. The fair value of forward exchange contracts and options is their quoted market price at the balance sheet date, being the present value of the quoted forward price.

### Cash Flow Statement

As the ultimate holding company of the Dechra Pharmaceuticals PLC Group, the Company has relied upon the exemption in FRSI (Revised) not to present a cash flow statement as part of its financial statements.

### Dividends

Dividends are recognised in the period in which they are approved by the Company's shareholders or, in the case of an interim dividend, when the dividend is paid.

Dividends receivable from subsidiaries are recognised when either received in cash or applied to reduce a creditor balance with the subsidiary.

### Interest-Bearing Borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

### Related Parties

Under FRS8 the Company has relied upon the exemption not to disclose related party transactions with other Group undertakings as they are all included in the Dechra Pharmaceuticals PLC Consolidated Financial Statements.

**Employee Benefits**

**(i) Pensions**

The Company operates a Group stakeholder personal pension scheme for certain employees. Obligations for contributions are recognised as an expense in the profit and loss account as incurred.

**(ii) Share-Based Payment Transactions**

The Company operates a number of equity-settled share-based payment programmes that allow employees to acquire shares of the Company. The Company also operates a Long Term Incentive Plan for Directors and senior executives.

The fair value of shares or options granted is recognised as an employee expense on a straight-line basis in the income statement with a corresponding movement in equity. The fair value is measured at grant date and spread over the period during which the employees become unconditionally entitled to the shares or options (the vesting period). The fair value of the shares or options granted is measured using a valuation model, taking into account the terms and conditions upon which the shares or options were granted. The amount recognised as an expense in the profit and loss account is adjusted to take into account an estimate of the number of shares or options that are expected to vest together with an adjustment to reflect the number of shares or options that actually do vest except where forfeiture is only due to market-based conditions not being achieved.

The fair values of grants under the Long Term Incentive Plan have been determined using the Monte Carlo simulation model.

The fair values of options granted under all other share option schemes have been determined using the Black-Scholes option pricing model.

**Taxation**

The charge for taxation is based on the profit for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes. Deferred tax is measured on a non-discounted basis at the tax rates that are expected to apply in the periods in which the timing differences reverse and is provided in respect of all timing differences which have arisen but not reversed by the balance sheet date, except as otherwise required by FRS19 “Deferred Tax”.

**Financial Guarantee Contracts**

The Company has not adopted amendments to FRS26 in relation to financial guarantee contracts which apply for the period ended 30 June 2007.

Where the Company enters into financial guarantee contracts to guarantee the indebtedness of other companies within its Group, the Company considers these to be insurance arrangements, and accounts for them as such. In this respect, the Company treats the guarantee contract as a contingent liability until such time as it becomes probable that the Company will be required to make a payment under the guarantee.

The Company does not consider the amendments to have any impact on the financial statements for the period ended 30 June 2007.

# Notes to the Financial Statements continued

## (ii) Directors and Employees

Total emoluments of Directors (including pension contributions) amounted to £1,055,000 (2006: £747,000). Information relating to Directors' emoluments, share options and pension entitlements is set out in the Directors' Remuneration Report on pages 30 to 33.

Including Directors, the average number of staff employed during the year solely in an administrative function was 8 (2006: 8). The costs incurred in respect of these employees were:

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Wages and salaries | 1,042 | 601 |
| Social security costs | 125 | 77 |
| Other pension costs | 80 | 61 |
| Share-based payments charge | 195 | 173 |
| | 1,442 | 912 |

At 30 June 2007, outstanding pension contributions of £7,000 (2006: £5,000) were included in creditors.

## (iii) Auditors' Remuneration

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Audit of the parent company financial statements | 15 | 14 |

Amounts paid to the Company's auditors in respect of services to the Company, other than the audit of the Company's financial statements, have not been disclosed as the information is required instead to be disclosed on a consolidated basis.

## (iv) Fixed Asset Investments

| | Shares in Subsidiary Undertakings £'000 |
|---|---|
| Cost and net book value | |
| At 1 July 2006 | 53,408 |
| Additions | 1,250 |
| **At 30 June 2007** | **54,658** |

A list of principal subsidiary undertakings is given in note xii.

During the year, the Company acquired Leeds Veterinary Laboratories Limited.

Where subsidiaries are acquired for shares, or a combination of shares and cash, statutory merger relief has been applied and accordingly cost includes the nominal value of shares issued.

## (v) Debtors

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Amounts owed by subsidiary undertakings | 10,724 | 42,403 |
| Group relief receivable | 1,218 | 775 |
| Deferred taxation (see note ix) | 275 | 260 |
| Other debtors | 61 | 11 |
| Prepayments and accrued income | 88 | 87 |
| | 12,366 | 43,536 |

Included in debtors are amounts of £275,000 (2006: £260,000) due after more than one year.

### (vi) Creditors

| | Falling due within one year | |
|---|---|---|
| | **2007** | 2006 |
| | **£'000** | £'000 |
| Bank loans and overdrafts (see note vii) | **10,190** | 3,000 |
| Amounts due to subsidiary undertakings | **12,540** | 48,551 |
| Other creditors | **9** | 8 |
| Other taxation and social security | **54** | 60 |
| Accruals and deferred income | **555** | 471 |
| | **23,348** | 52,090 |

In accordance with FRS21, Events after the Balance Sheet Date, the proposed final dividend for the year ended 30 June 2007 of 5.00p per share has not been accrued for in these financial statements. It will be shown in the financial statements for the year ending 30 June 2008. The total cost of the proposed final dividend is £2,640,000.

| | Falling due after more than one year | |
|---|---|---|
| | **2007** | 2006 |
| | **£'000** | £'000 |
| Bank loans (see note vii) | **10,120** | 14,095 |

### (vii) Borrowings

| | **2007** | 2006 |
|---|---|---|
| | **£'000** | £'000 |
| Borrowings due within one year | | |
| Bank overdraft | **6,190** | — |
| Bank loan | **4,000** | 3,000 |
| | **10,190** | 3,000 |
| Borrowings due after more than one year | | |
| Aggregate bank loan instalments repayable: | | |
| between one and two years | **5,000** | 4,000 |
| between two and five years | **5,200** | 10,200 |
| | **10,200** | 14,200 |
| Arrangement fees netted off | **(80)** | (105) |
| | **10,120** | 14,095 |
| Total borrowings | **20,310** | 17,095 |

The term loan from Bank of Scotland is secured by a fixed and floating charge on the assets of the Group. Interest is charged at 1.25% over LIBOR.

The Company guarantees certain borrowings of other Group companies, which at 30 June 2007 amounted to £2,075,000 (2006: £1,239,000).

# Notes to the Financial Statements continued

## (viii) Financial Instruments

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Changes in fair value (charged)/credited to profit and loss | (46) | 30 |

Details of valuation techniques and fair values of each category of financial instruments are given in note 20 to the Consolidated Financial Statements in the section headed 'Fair values of Financial Instruments'.

## (ix) Deferred Tax

| | £'000 |
|---|---|
| At 1 July 2006 | (260) |
| Transfer to profit and loss account | (15) |
| **At 30 June 2007 (included in debtors)** | **(275)** |

The amounts provided for deferred taxation at 28% (2006: 30%) are as follows:

| | 2007 £'000 | 2006 £'000 |
|---|---|---|
| Short term timing differences | (275) | (260) |
| Total | (275) | (260) |

## (x) Called up Share Capital

| Issued share capital | £'000 | Ordinary Shares of 1p each No. |
|---|---|---|
| At 1 July 2006 | 519 | 51,915,002 |
| New shares issued | 9 | 888,697 |
| **At 30 June 2007** | **528** | **52,803,699** |
| Authorised share capital | | |
| **At 30 June 2007 and 30 June 2006** | **750** | **75,000,000** |

During the year, 873,889 new ordinary shares of 1p were issued following the exercise of options under the Executive Incentive Plan and the Approved, Unapproved and SAYE share option schemes. The consideration received was £357,000 (2006: £748,000).

In addition, 14,808 new ordinary shares of 1p (2006: nil) were issued in part consideration for the acquisition of Leeds Veterinary Laboratories Limited. The market value of these new ordinary shares of 1p at the date of issue was £50,000.

**Share Options**

Details of outstanding share options over ordinary shares of 1p at 30 June 2007 under the various Group share option schemes are shown in note 22 to the Consolidated Financial Statements.

## (xi) Reserves

| | Share premium account £'000 | Hedging reserve £'000 | Profit and loss account £'000 |
|---|---|---|---|
| At 1 July 2006 | 27,693 | (71) | 4,256 |
| New shares issued | 348 | — | — |
| Profit for the financial year | — | — | 3,925 |
| Dividend (see note 8 to Consolidated Financial Statements) | — | — | (3,595) |
| Share-based payments charge | — | — | 479 |
| **At 30 June 2007** | **28,041** | **(71)** | **5,065** |

### (xii) Subsidiary Undertakings

The principal subsidiary undertakings of the Company, all of which are wholly owned, are:

| Company | Country of Operation | Country of Incorporation | Principal Activity |
|---|---|---|---|
| Dechra Limited§ | UK | Great Britain | Wholesaler, marketer and manufacturer of pharmaceuticals; Wholesaler and marketer of veterinary products, instruments and equipment; Provider of veterinary laboratory services |
| Dechra Investments Limited | UK | Great Britain | Holding company |
| National Veterinary Services Limited* | UK | Great Britain | Non-trading |
| Arnolds Veterinary Products Limited* | UK | Great Britain | Non-trading |
| Dales Pharmaceuticals Limited* | UK | Great Britain | Non-trading |
| Veneto Limited | UK | Great Britain | Holding company |
| North Western Laboratories Limited | UK | Great Britain | Non-trading |
| Cambridge Specialist Laboratory Services Limited† | UK | Great Britain | Non-trading |
| Anglian Pharma Manufacturing Limited‡ | UK | Great Britain | Non-trading |
| Anglian Pharma Limited | UK | Great Britain | Holding company |
| Dechra Veterinary Products LLC | USA | USA | Distributor of veterinary products |
| Leeds Veterinary Laboratories Limited | UK | Great Britain | Provider of veterinary laboratory services |

* 100% of ordinary share capital held by Veneto Limited. Voting preference shares held by Dechra Pharmaceuticals PLC Employee Benefit Trust.

§ 100% of ordinary share capital held by Dechra Investments Limited.

† 100% of ordinary share capital held by North Western Laboratories Limited.

‡ 100% of ordinary share capital held by Anglian Pharma Limited.

# Shareholders' Notes

# Advisers



### Merchant Bank & Financial Advisers
NM Rothschild & Sons Limited
New Court
St Swithins Lane
London
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